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MISCELLANEOUS TAX BILLS—1991

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

S. 90, S. 150, S. 267, S. 284
S. 649, and S. 913

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MISCELLANEOUS TAX BILLS—1991

WEDNESDAY, JUNE 12, 1991

U.S. SENATE,
SUBCOMMITTEE ON TAXATION,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:36 a.m., in room SD-215, Dirksen Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Also present: Senators Moynihan, Baucus, Bradley, Mitchell, Breaux, Chafee, and Packwood.

[The press release announcing the hearing follows:]

[Press Release No. H-20, May 24, 1991]

SUBCOMMITTEE HEARING PLANNED ON MISCELLANEOUS TAX BILLS; COMMENTS SOUGHT ON LEGISLATION

WASHINGTON, DC—Senator David Boren, Chairman of the Senate Finance Subcommittee on Taxation, announced Friday that the subcommittee will hold a hearing on a series of miscellaneous tax bills.

The hearing will be at *10 a.m. Wednesday, June 12, 1991* in Room SD-215 of the Dirksen Senate Office Building.

The bills include:

- S. 90, to modify the tax-exempt bond and depreciation rules with respect to infrastructure facilities.
- S. 150, to generally treat bonds issued for section 501(c)(3) organizations in a manner similar to governmental bonds.
- S. 267, to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that State.
- S. 284, to amend the tax treatment of payments under life insurance contracts for terminally ill individuals.
- S. 649, to repeal the luxury tax on boats.
- S. 913, to increase the amount of bonds eligible for certain small governmental issuer exceptions and to modify other tax rules with respect to bonds issued by state and local governments.

"This hearing will give us an opportunity to examine these bills more closely and hear from parties who are likely to be affected by the legislation," Boren said.

OPENING STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA, CHAIRMAN OF THE SUBCOMMITTEE

Senator BOREN. Today's hearing of the Subcommittee on Taxation has been scheduled to consider testimony relating to six different bills: S. 90, the Environmental Infrastructure Act, by Senator Domenici, to modify the tax-exempt bond and depreciation rules with respect to infrastructure facilities; S. 913, the Tax Exempt Bond Simplification Act, by Senator Baucus to increase the amount of bonds eligible for certain small-issuer exceptions, and to

modify other tax rules with respect to bonds issued by State and local governments; S. 150, the Higher Education Tax-Exempt Reform Act, by Senator Moynihan, to treat bonds issued for Section 501(c)(3) organizations in a manner similar to government bonds; S. 649 by Senator Breaux to Repeal the Luxury Excise Tax on Boats; S. 284, the Living Benefits Act, by Senator Bradley to amend the tax treatment of payments under life insurance contracts for terminally ill individuals, and S. 267 by Senator Reid to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that State. We have a large number of witnesses scheduled to testify today, including several members of Congress, who feel strongly about one or more of these bills. We are also pleased to be joined by several State and local government officials who can tell us firsthand about the struggle that they face in financing their operations.

We have an extraordinarily large number of witnesses scheduled to testify this morning At the latest count, I note we have 32 witnesses scheduled to testify; there may be two or three others added to the list, and some members may wish to appear this morning, as well.

This is due, in part, to the large number of bills scheduled for the hearing; but it is largely due, as I say, both to the unexpected number of members who wish to testify—I believe 14 members this morning—and to a number of member requests for inclusion of particular witnesses.

There is a 2:00 o'clock hearing scheduled here for Senator Bradley's Deficit Subcommittee, so this hearing is going to have to adjourn sometime after 1:00 o'clock—at the very latest, by 1:30.

As a result, I would like to ask all the witnesses to proceed in a quick manner. We are going to have to set a shorter time limitation than usual. We will use the light system and hold our witnesses to 4-minute summaries of their statements—their full statements will be included into the record—so that we will have an opportunity for questions.

I also want to make a brief comment about the Domenici and Baucus bills which will be addressed together today by our panelists. The bottom line is that the Federal Government continues to impose mandates on State and local governments, especially through environmental standards.

Some of these requirements are reasonable, but most are expensive to achieve. It is likely that this Congress will see this trend continue as it re-writes the Resource Conservation and Recovery Act—RECRA—and the Clean Water Act. The current debate on education policy may result in additional requirements on the States.

It is therefore obvious that the Federal Government will be unable to provide large amounts of direct assistance to local governments because of our budgetary problems.

Having had the experience of serving as a Governor—charged with meeting these kinds of local responsibilities to meet Federal mandates, even those very worthy mandates with which I strongly agreed. I personally understand the struggle that those at the State and local level are undergoing.

That is why many of us believe that we can get more services for the Federal dollar through changes to the Tax Code that help State and local authorities raise the money necessary to meet these needs through the issuance of tax-exempt bonds, rather than through direct outlays, which, frankly, we cannot afford at this time.

So, with this general goal in mind, I look forward to hearing the testimony today from the various witnesses who will appear before us.

Before I turn too our witnesses, I want to turn to the members of the committee who are here for any opening statements. I see the distinguished Majority Leader is here, and I know that he has a very busy schedule this morning. So I, with the consent of the members of the committee, will turn to him first.

Senator Chafee has also spoken to me about time constraints under which he is operating, so we will hear any opening comments first from Senator Mitchell, then from Senator Chafee, Senator Baucus, and Senator Breaux.

[The prepared statement of Senator Boren appears in the appendix.]

OPENING STATEMENT OF HON. GEORGE J. MITCHELL, A U.S. SENATOR FROM MAINE

Senator MITCHELL. Mr. Chairman, thank you very much. I would like to make just a couple of brief comments. First, a welcome to three witnesses from Maine who will testify at this hearing: Congresswoman Snowe, and Shepard McKenney, the chairman of the Hinckley Co., will be testifying on the 10-percent excise tax on boats.

The subcommittee will also hear testimony from Sam Shapiro, the Treasurer of the State of Maine, who will be testifying on the bank eligibility rules for tax-exempt bonds.

Boat manufacturers have expressed their deep concern to me about the 10-percent excise tax on boats. To accommodate their concerns, I asked Chairman Bentsen if the committee would hold a hearing on this issue, and I am pleased that this hearing is taking place today.

The industry in Maine and around the country is in serious trouble. Sales are down; people have lost jobs. That is of great concern to me, as I know it is to Senator Chafee, Senator Breaux, and all of us. The industry believes that the luxury tax is a major cause of its problems.

I requested this hearing to give the industry a chance to present its case, and to give the members of this committee the chance to hear and consider that case.

I have also joined Senators Breaux, Chafee and Bradley in requesting that the Internal Revenue Service provide information to Congress with respect to the cost of administering the boat excise tax, the revenues expected to be generated by the tax, and the estimated loss of income tax revenues resulting from job losses in the industry due to the tax.

Finally, the General Accounting Office is now conducting a study of the economic effects of the boat excise tax. It is my hope that the

record developed today and later by the Internal Revenue Service and the General Accounting Office will enable Congress to carefully take another look at this issue to determine the appropriate public policy. If that record establishes that as a result of the imposition of the tax large numbers of jobs have been lost and revenues are down, then I will do all I can to obtain repeal of the tax. Mr. Chairman, there is a long list of witnesses for the hearing, and my responsibilities as Majority Leader do not permit me to stay for the entire hearing. I do hope to return for the panel testifying on boat excise taxes, the floor schedule permitting.

I thank you, Mr. Chairman, for your courtesy.

Senator BOREN. Thank you very much, Senator Mitchell.

Senator Chafee.

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Thank you very much, Mr. Chairman. And I want to thank you for holding this hearing on S. 649, amongst others. S. 649 is a bill that Senator Breaux and I have introduced to end the so-called luxury tax on boats. I want to welcome Mr. Everett Pearson here, from Rhode Island, who is going to testify on this subject. May I say that also I have a matter on the floor, but will return for the panel that deals with the boat tax.

Mr. Chairman, this new tax was meant to soak the rich by putting taxes on luxuries such as airplanes, boats, furs, jewelry, expensive cars. However, it turned out to not tax the rich, but tax the middle income/lower income people who build boats, and it has been a disaster.

It is a very unfair tax. It does not deal with all the items that might be perceived as luxuries. For example, it does not address the purchase of a $250,000 second home in Vail, Colorado, or Hilton Head, South Carolina.

The tax can be avoided by purchasing a boat from a foreign manufacturer and registering it in a foreign country, such as the Bahamas. And, indeed, the government of the Bahamas is reducing its taxes on boats registered in that country and is encouraging Americans to purchase and register their boats outside of the United States.

The main reason the tax is unfair, however, Mr. Chairman, is that it has had a dramatic impact on the boat-building industry. It is not a tax on the people that buy these boats; it is a tax on the boat-building industry. And it is being paid by American workers who have lost their jobs as a result of the slow down in large boat sales.

The boat-building industry obviously is sensitive to the economy. We recognize that. When the economy goes down, boat sales go down. And thus, boat sales dropped from 1988 to 1990 by 40 percent. After this tax was enacted 8 months ago, the boat-building industry experienced another 25-percent drop in sales.

It is estimated that 19,000 boat builders across the country will lose their jobs; already in our State 1,400 have lost their jobs, and we expect more. According to the Joint Committee on Taxation,

this luxury tax on boats was meant to raise $3 million in 1991, and $148 million over the next 5 years.

That did not take into account the cost of collection, the economic impact it would have on jobs and the ability of those individuals and the employers—the companies—to pay Federal income taxes, as well as payroll taxes. And, of course, we have had increased unemployment compensation payments.

I will just tell you a little bit about my State, Mr. Chairman. We have a million people. We produce more sail boat hulls than any State in the Nationfrom that small State. But there are a lot of other industries associated with it, such as those companies that make the lines, the winches, the sails, the spars, the masts, and many other parts that are associated with boat-building. All of them have suffered.

And Mr. Chairman, the unusual thing was that the large boat sales during recessions have generally held up pretty well in the past. But this luxury tax has killed off those large boat sales even during a recession.

David Walters, from his company, writes that his company sold about six sail boats a year in the price range from $300,000 to $600,000. Since the tax went in, they have not received a single order, and he has closed his boat yard.

Pearson Yachts, going for over 30 years, employing 275 people in our State less than 2 years ago, has closed its doors. They have not sold any of the large boats. We are going to hear from Mr. Pearson, but I would like to mention Ted Hood, whom he will refer to in his testimony. The last contract for a big boat received by his large custom boat-building operation was last September. Three other contracts being negotiated fell through when the tax came in.

In conclusion, this is a terribly unfair tax. It is not on wealthy Americans, but it is on skilled American workers who are employed in the boat-building industry.

Mr. Chairman, I hope we can remove this tax and remove it quickly so that we can get on with those jobs involved with the boat-building industry.

Thank you.

Senator BOREN. Thank you very much, Senator Chafee. Senator Baucus, is there any opening comment that you would like to make?

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. First, thank you very much for switching on the microphone switch. Second, for holding this hearing. And third, Mr. Chairman, just the point that you made. These communities, local municipalities in our country are very, very strapped.

In Montana, for example, tax receipts are down by about 2 percent, and yet, inflationary cost that municipalities are facing, which is 15 some percent, so that on an effective basis in Montana, communities have 17 percent less revenue to meet more needs than they had formerly. And I think that the legislation that we are considering this morning will go a long way—not enough—but at

least a long way to alleviate some of the financial constraints that our communities are facing.

And I thank you for holding this hearing.

Senator BOREN. Thank you very much, Senator Baucus. Senator Breaux, any opening comments that you would like to make?

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX. Very briefly, Mr. Chairman. Thank you for starting our hearing today. It is going to be very extensive. I know that there are a number of subjects, and opening comments indicate that we are basically talking about the luxury tax on boats, which is an interest that I have, having the legislation which will repeal the so-called luxury tax on boats.

I know it is hard for everybody to believe, but every now and then Congress makes a mistake. And the luxury tax on boats is clearly an example of a good effort that has gone astray. Congress, in fact, made a mistake when we passed the so-called 10-percent luxury tax on large boats.

I think everybody thought we were going to get people who had a very high income to contribute to deficit reduction. And the early facts indicate that that is simply not happening. The last estimate that we have from the Joint Tax Committee shows that we are talking about $3 million in 1991. And the question is, is that worth the hardship and the lost jobs and the loss of businesses in this country to get $3 million? And I would suggest that the answer is clearly no.

If the industry was already in a downturn, I think we have shoved their head under water, because this is really the final blow to an industry which is struggling to survive.

There are so many exemptions and ways to avoid the tax by buying a used boat, by exporting the vessel and registering it overseas. People who are very wealthy are going to find a way to get around this tax.

The real losers are the middle class workers who do not have that option; they simply lose their job. Estimates as much as 18,000 jobs would be lost. I do not think that is worth $3 million a year in revenues. We have made a mistake, we should recognize it, we should correct it, we should pass my bill.

Mr. Chairman, I also want to being to the attention of my colleagues a recent independent study demonstrating how harmful this tax has been for the automobile sector as well. It projects substantial lost jobs and Federal and State revenue losses.

Mr. Chairman, I ask that you include in the record the study and the prepared statement of Mr. Robert M. McElwaine, executive director of the coalition that funded the study.

[The material appears in the appendix.]

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much, Senator Breaux. We will begin with our first witness this morning. Kenneth Gideon, the Assistant Secretary of Treasury for Tax Policy, who will make some summary comments about the various proposals before us.

If Senator Domenici arrives after Mr. Gideon, we will then turn to a panel consisting of Senator Domenici and Senator Dodd. They will discuss the Domenici and Baucus bills that were described earlier.

But let me first turn to Secretary Gideon for his comments to set the stage then for the testimony from the remainder of our witnesses.

STATEMENT OF HON. KENNETH W. GIDEON, ASSISTANT SECRETARY OF TREASURY FOR TAX POLICY

Assistant Secretary GIDEON. Mr. Chairman, members of the committee, I am pleased to be here today to present the views of the Administration on a number of revenue measures. I thank you for including my full written statement in the record.

[The prepared statement of Secretary Gideon appears in the appendix.]

Assistant Secretary GIDEON. We are generally concerned about the revenue costs of these proposals in view of the pay-as-you-go system adopted as part of the Omnibus Budget Reconciliation Act in 1990.

S. 649 would repeal the luxury tax on boats. We do not support repeal of the luxury boat excise tax at this time. The tax has been in effect for less than 6 months, a period which coincided with the economic downturn. It is simply too early to assess what its actual impact will be in terms of effect on the industry, revenues realized, or difficulty of administration.

S. 284 would amend Section 101 of the Internal Revenue Code to provide that amounts paid under a life insurance contract of a terminally ill insured would be treated as amounts paid by reason of the death of the insured and, therefore, excludable from gross income.

A terminally ill insured individual is defined as "an individual who has been certified by a licensed physician as having an illness or physical condition that can reasonably be expected to result in death in 12 months, or less." Other provisions of this bill are described in my written statement.

We oppose expansion of Section 101, as proposed. Section 101 currently provides for the exclusion from income of amounts paid under a life insurance contract by reason of the death of the insured.

We believe the fundamental family security rationale for the tax-free treatment of the inside build-up in life insurance would be undermined if the provision is broadened in the manner proposed.

While we are sympathetic to the goal of helping the terminally ill, let me simply note in briefly passing that the trigger proposed for early payment is particularly problematic.

A physician's certification that an individual has less than 1 year to live raises serious problems of administration. Audit of such a certificate would be virtually impossible, and if the standard is effectively unauditable, compliance concerns are certain to arise.

S. 913 would remove or liberalize certain existing restrictions on tax-exempt bonds. The bill contains seven specific provisions. Taking those provisions one by one:

We oppose increasing the $5 million small-issuer exception to arbitrage rebate to 25 million. The proposal would be expensive, and would defeat, in part, the policy of discouraging arbitrage motivated transactions.

We recognize that an argument can be made for increasing the small-issuer exception to 10 million to conform it to the $10 million small-issuer bank qualified bond exception. However, absent an acceptable offset, we do not support even such a limited expansion.

We oppose the proposal to make the 2-year spend-down exception to rebate retroactive. Our opposition is based both on our general policy of opposing retroactive tax legislation, and the fact that the proposal would provide a windfall for many issuers.

We oppose the proposal to increase the $10 million bank qualified exception to $25 million. We do not believe there is a justification for granting financial institutions additional relief under Section 265.

We do not oppose the proposal to repeal the 5-percent private interest business use test, provided that an acceptable offset is provided. This part of Section 141 is often misunderstood by issuers and is not easily administered by the Internal Revenue Service.

We are in general agreement with the notion that it should not be necessary to apply both yield restriction and arbitrage rebate restrictions to the same bond issue.

There may, however, be circumstances in which arbitrage rebate alone may not be sufficient to prevent issuances with the significant purpose of earning arbitrage. Therefore, we would request residual authority in the Treasury to impose yield restriction.

We believe that the proposal to permit issuers to retain a percentage of the arbitrage earned merits serious consideration, but we think that it needs further study.

We support the proposal to define certain advance funding bonds as a device under Section 149.

S. 90 would accord bonds issued to finance "infrastructure facilities" the same treatment that non-private activity governmental bonds currently receive under the Code.

There are three provisions in this bill. Let me outline quickly our position on each of those.

We oppose treating infrastructure bonds as governmental bonds. This provision would result in a significant increase in the amount of tax-exempt bonds issued.

We oppose the proposed 3-year exception to arbitrage rebate. This proposal was considered and rejected when Congress reached agreement with respect to the 2-year spend-down exception to arbitrage rebate.

We oppose treating infrastructure facilities as 7-year ACRS property and is exempt from the treatment as tax-exempt use property. We do not believe that there is a basis for allowing accelerated depreciation on such facilities in addition to the implicit Federal subsidy arising from tax exemption on the indebtedness.

All three of these items would result in significant revenue loss.

Finally, S. 150 would generally treat bonds, the proceeds of which are loaned to or used by Section 501(c)(3) organizations for their exempt 501(c)(3) purposes, in the same manner as governmen-

tal bonds. This would effectively repeal the limitation on such bonds added in the Tax Reform Act of 1986.

We oppose this proposal. It would significantly expand a large class of tax-exempt obligations and would result in significant revenue loss to the Federal Government.

Mr. Chairman, I would be pleased to answer any questions which you and other members may have at this time.

Senator BOREN. Secretary Gideon, do you have in front of you the revenue estimates or estimates of lost revenue from these various proposals?

Assistant Secretary GIDEON. I do not have specific revenue estimates with me today, Senator, but we can provide those, if you wish.

Senator BOREN. In weighing the position that Treasury has taken—which is mainly negative on most of these proposals—have you considered the additional costs mandated upon State and local governments? In deciding whether or not this merits some consideration by the Federal Government, have you made any effort to determine the additional cost for State and local governments, or in some instances, for certain elements of the private sector, to comply with some of the mandated changes—for example, in the environmental field?

Assistant Secretary GIDEON. I think that to the extent that that refers to the infrastructure bill, which I think is the one to which it primarily relates, we question whether an expansion of tax-exempt bonds would be the most efficient way to deal with that issue.

If Congress wishes to provide relief to the States, we think it might far more efficiently do that through some other method. Any use of tax-exempt bonds involves some loss that really does not go to the States, but is felt in the loss of revenue to the Federal Government. We just do not think it is an efficient subsidy.

Senator BOREN. Do you feel that a direct subsidy would be less expensive, or is there any data that would demonstrate this in terms of the need?

Assistant Secretary GIDEON. I think that as compared with a tax-exempt bond, a direct subsidy might well be less expensive.

Senator BOREN. Questions from other members of the committee.

Senator BAUCUS. I have no questions.

Senator BOREN. Senator Breaux.

Senator BREAUX. Thank you, Ken, for being with us, and having to be an expert on so many different areas.

Let me just ask a couple of things on the luxury tax on boats. You basically say that it is too early to support a repeal of it because it has been in effect for less than 6 months.

I have taken the position that if we made a mistake, we ought to try and correct it as early as possible and not let it continue to cause problems and get set into place for a longer period of time.

We sent a letter to Commissioner Goldberg signed by four members from the committee asking for some estimates. And I am wondering if your department has any preliminary indications of any of the effects of the so-called luxury tax.

I know you have not completed it yet, but what we ask for, to give us estimates on the cost of administering the tax, the revenues

expected to be generated, the estimated loss of income tax as a result of any lost jobs in the boating industry. Do we have any kind of early indications from you folks as to the trend in any of these areas that we asked for?

Assistant Secretary GIDEON. I do not think that we are going to be able to give you data on many of the areas that you ask for, simply because the data simply does not come in that fast. What we do have is some preliminary data on collection, and I would stress that it is preliminary, because in the initial implementation of any tax, we find that—the IRS is still receiving, for example, first quarter returns.

But as of May 25th, which is the last date that we had, we believe that collections under the boat excise tax were approximately $900,000. That would relate only to the first quarter period.

Senator BREAUX. Let me ask you the question, some of the studies that have been done by the industry that is affected——

Assistant Secretary GIDEON. Yes.

Senator BREAUX [continuing]. They are generally the people who would best be able to give us that information early-said that in the first 3 months alone, the taxes resulted in a 38-percent decline in retail jobs in their industry. And, and during that same period, sales are down 86 percent—almost $95 million over the same period last year. Now, I know it is hard to say what is the reason for that, recession, or people are just not buying boats because of the difficult economic times, but do you have any thoughts about what they have told us the effect has been, as to the validity of decline that they are projecting from their results?

Assistant Secretary GIDEON. I think that we do not have data that would allow us to disagree with them at this point, but I think that you have already pointed out some of the reasons to wonder whether at this point in time we really can assess this.

I mean, the first 6 months of this tax did coincide with the economic downturn. Obviously, this kind of purchase tends to be affected. It often is a discretionary purchase. It is the sort of thing that people may choose to forego. So, there is a question, I think, legitimately, about what the specific impact of the tax itself might have been.

Second, and I think this is just a fact—I do not criticize members for making these proposals, but it is a fact of life that if the public believes there is a serious possibility of repeal, that in itself may have an effect on how fast they are willing to jump out there and make purchases.

Senator BREAUX. Let me just ask one final question, Mr. Chairman. I know that if an industry is in a downturn already, adding a 10-percent tax to it is certainly not going to help it recover. It has just the opposite effect; it pushes it even faster into a downturn. But how long do you think a period of time needs to pass before your type of reflections on the effect of a tax would need to be a valid reflection?

Assistant Secretary GIDEON. Well, let me parse that question into its pieces. If you are asking how long would it be until we had a good data base, that period typically takes us 2 or 3 years, minimum. On the other hand, that may well be beyond the period of time that those in the Congress want to wait to do that sort of

thing. But if you are asking me a data question, it will take awhile to get a good data base.

Senator BREAUX. I thank you, Ken.

Mr. Chairman, I am only concerned that if you waited for that period to occur, we may not have a problem, because we may not have an industry left.

Thank you.

Senator BOREN. Thank you very much, Senator Breaux. Mr. Gideon, we appreciate your comments. And I think in the press of time, we will receive, of course, your full statement for the record, which you have summarized for us. I see Senator Domenici is not yet here, but I know that Senator Dodd must go on to a mark-up, so we will proceed with Senator Dodd, who will, I believe, address S. 913. Is that correct, Senator Dodd?

Senator DODD. Correct.

Senator BOREN. And then Senator Reid is not yet here, but Representative Vucanovich is here, and also Senator Bryan is here. And we will proceed with them immediately after we hear from Senator Dodd.

Senator Dodd, we appreciate your understanding of our time constraints today. We know you are under pressure, and we would welcome your comments on S. 913.

STATEMENT OF HON. CHRISTOPHER J. DODD, A U.S. SENATOR FROM CONNECTICUT

Senator DODD. Well, thank you very much, Mr. Chairman. First of all, I appreciate immensely the opportunity to be able to appear before the committee today, and I will ask in advance that any prepared statements and supporting material be included in the record at the discretion of the Chair.

Senator BOREN. Without objection, we will receive your full statement.

[The prepared statement of Senator Dodd appears in the appendix.]

Senator DODD. I will just quickly comment as well on two other matters. Senator Breaux talked about the luxury boat tax, and I am a co-sponsor of that legislation. As he points out, by the time we get the data, there will not be much of an industry left.

It is a vitally important industry all across this country, but particularly in coastal States. Certainly Louisiana and Connecticut have been adversely affected by this.

When I think of that, Mr. Chairman, and think of the Tax Reform Act of 1986, I remember that wonderful commentator on language, Yogi Berra, who said, "it is a great pity that we do not have hindsight in advance." His comments certainly are applicable to this situation.

Also, Mr. Chairman, you will be hearing testimony a little bit later on S. 284, the Living Benefits Act. Knowing the demands the Federal Government is under—it seems to me this piece of legislation makes all the sense in the world in terms of meeting the public policy of allowing people to live out their remaining few days with a sense of dignity and allowing them to have access to

some of their life insurance benefits during those limited days, I strongly support that legislation, as well.

Mr. Chairman, I am here this morning primarily to comment on a piece of legislation introduced by my good friend and colleague, Senator Baucus, and co-sponsored by the Chair, dealing with our local governments, S. 913, the Tax-Exempt Bond Simplification Act.

Mr. Chairman, you will be hearing from four State Treasurers later this morning, from Ohio, California, Texas, and Maine. They strongly support this legislation, as do a variety of other public affiliations that recognize the importance of this particular legislation.

Mr. Chairman, I have already held some hearings on the plight of municipalities. In a sense, I was stepping a bit beyond the limitations of my jurisdiction as the chairman of the Subcommittee on Securities. We looked at municipal securities and what is happening in cities.

What Senator Baucus has proposed had a ringing endorsement from people who are working to address the funding needs of our cities and counties.

Our hearing record produced dramatic testimony about the magnitude of the problems facing State and local governments. And I will submit for the record those reports from the National Governors' Association, the National League of Cities, and the U.S. Conference of Mayors.

The National Governors' Association report states that, "From Connecticut to California State, fiscal conditions in 1991 are the worst in nearly a decade. The most important single indicator of State fiscal health, total balances has fallen to a level of $5.9 billion, or just 2 percent of expenditures," to quote that report.

If you leave out Alaska, State balances are about 1.5 percent of expenditures. That is less than one-third of what they were just 2 years ago.

The Governors' report shows that 29 States have reduced their fiscal 1991 budgets by $8 billion in this country. Proposed State tax and other revenue increases for fiscal 1992 now totals $6.6 billion, and are likely to grow if the recession persists.

More tax increases and budget cuts will be necessary for many States just to keep their heads above water. We cannot forget about funding new bridges, roads, and schools.

I know there are some who say that we are moving out of this recession. I hope that is true, Mr. Chairman, but I am not convinced that that is the case. The dramatic budget cuts and tax increases that are occurring in State after State across this country, at best, will be a serious drag on any recovery; and at worst, they will push us even deeper into the recession.

And what about this crisis in our cities, Mr. Chairman? Of course, all of you must be aware of what has happened to the largest city in my home State of Connecticut—the most affluent State in the Nation, by the way, on a per capita income basis—and yet Hartford, Bridgeport, and New Haven rank as the fourth, seventh, and ninth poorest cities in America with populations over 100,000.

Mr. Chairman, I would just cite some statistics to tell you what is going on here. Put aside the recession. Put aside the credit crunch we are facing.

In 1960, per capita income of people living in urban areas was 105% of the per capita income of people living in the immediate surrounding suburban communities. That was 1960. In 1980, it was almost 90 percent. That was 10 years ago. In 1987, it was about 57 percent. It has just fallen off the ledge. That is number one.

Number two, in 1980, the Federal Government contributed on the average about 17.5 percent of the funding needs of local budgets. That is when we had a deficit in this country of $35 billion on an annual basis. Today we are contributing about 6.2 percent of the funding needs of those same urban areas. So consider those statistics: the diminishing tax base to support what is needed in these cities, and the lack of Federal contribution. Now, consider what we are trying to do in this legislation. That is to attract what has been an historic major asset to our States and cities, tax-free bonds. Congress added tremendously to the cost of issuing these bonds as a result of the 1986 Tax Act. There is a great deal of data, Mr. Chairman, in my testimony about these additional costs.

Just to give you an idea of what we are talking about, I am told by Connecticut Treasury officials that before the passage of the 1986 Act, bond counsel fees for a $150 million issue were about $50,000. And the documents were about a half an inch think. That is a general comment.

Today, the bond counsel fees as a result of the 1986 Tax Act for an issue of that size range from $250,000 to $350,000. And the documents they have to file are about 4 inches thick.

So, with the 1986 Tax Act, the intention was to try and expedite things and make it simpler, but we just added tremendously to these costs and to the bureaucracy that is associated with it. And so, we are strangling what historically has been a very important and vital means to assist local governments.

Mr. Chairman, I included some other material here. I see my colleague from New Mexico is here. He has a different kind of proposal, dealing with environmental infrastructure, but nonetheless, I think, it is equally important.

I want to commend Senator Baucus for taking the lead on this issue. I am honored to be a co-sponsor with him. I realize that you have a large agenda and many issues to consider.

But, in addition to what we have to do in terms of tightening the belt at local and State levels—and they are certainly trying to do that—we should also be aware that as a result of the changes in 1986, it is almost impossible for these cities and States to be able to attract revenues to support the vitally needed infrastructures they must have in order to grow.

So, my compliments to the committee.

Senator Boren. Thank you very much, Senator Dodd. I think those statistics you cited about the shrinking ability of the inner cities, for example, to meet their responsibilities are really, really dramatic.

And many of us are involved in trying to help some of those communities struggle with those problems. I have the privilege, because of university involvement, of trying to help one of the cities in your home State grapple with these problems—New Haven—and I have seen in a very dramatic fashion just what the shrinking

tax base does when the needs are increasing at an inverse proportion to the ability to meet them.

And then when we make it even more difficult for these communities to obtain the borrowing capability and add to the cost of borrowing to meet these needs, we just hit them again and make it even more difficult for them to ever climb out of this cycle.

You probably heard Secretary Gideon's comment saying that he felt that one: we could not absorb the revenue loss that would come from the changes that are advocated in both S. 913 and S. 90, which relate to the same problems.

He also indicated that, well, if we wanted to help the local communities, maybe a better way to do it was through direct subsidies and direct grants, and so on. I wonder if you would have any comments about his statement in that regard.

Senator DODD. Well, Mr. Chairman, first of all, I should point out that the headline last week was Bridgeport, but if we think that is the end of it, we are deluding ourselves. You mentioned New Haven. That may not be far behind Philadelphia. This is going to go right across the country. So, what happened in Bridgeport, Connecticut is not an isolated example of what is going on, and that point you make, I think, is important.

We have looked at and obviously anticipated your question about the revenue losses and the offsets here. We actually believe that the numbers are not quite clear.

In fact, we think the Joint Tax Committee numbers—and Senator Baucus certainly is aware, if not more aware than I am about this—are actually high. In fact, the revenue loss may be substantially less than what has been suggested. Talking more, probably, in the neighborhood of 300 million, or a little higher than that, rather than the 700 million I think they were talking about for S. 913.

But Mr. Chairman, the hard realities of life are such that, with a deficit that we are operating under, we cannot realistically come up with the kind of resources for our cities that historically the private sector has generated.

And frankly, it may be more efficient, as I heard Mr. Gideon suggest. I do not argue that it is more efficient, I suppose, to write a check from the Federal Government. But being efficient and practical is another matter here, and we just do not have the resources to be able to do it. Historically, we have been able to attract private dollars into these areas. That is far more realistic, it seems to me.

Senator BOREN. I would make only one comment. I agree with everything you said. I would add to it—and maybe again, this is the former Governor coming out in me—that I never saw a single program that we operated at the State level, a direct grant program, a social program, or any other program, in which we operated at a higher overhead than did the similar program by the Federal Government.

We usually operated with a 10th the number of people in overhead. There were also a lot fewer strings attached, a lot fewer application forms, and a lot lower mountain of paper work involved.

And I have some difficulty in believing direct grant approaches are the most efficient solutions, given the application process, with

the Federal bureaucratic overhead involved, and all the associated guidelines and regulations, and the legal staff required to understand those regulations. I usually find that the Tax Code is a more effective way, in many respects, of helping people devise ways to meet their own local responsibilities than that kind of direct grant process.

I have never been convinced that some of those subsidies that stimulated the rebuilding of our inner cities through the Tax Code were necessarily less costly or less desirable than some of our HUD programs, which have received such great reviews in the past in terms of their cost, and so on. So, I wonder if my perception is accurate.

Senator DODD. No, I think your point is well-taken. I would recommend as well, Mr. Chairman, if you have not seen it already, a study done by a Mr. Ashauer. People who are specialists in this field have examined it pretty closely. He compares the investment in public infrastructure and productivity rates.

Senator BOREN. Right.

Senator DODD. And has drawn the conclusion that there is a direct correlation. When you fail to invest an infrastructure, it has a dramatic impact on productivity rates. But your point is very well-taken.

Senator BOREN. Any questions, Senator Baucus?

Senator BAUCUS. I want to just thank you, Senator, for your committee's work. I mean, the data you have developed is very compelling. It just buttresses and complements the testimony and experience of others around the country. And I very much thank you for all your work.

Senator DODD. Thank you.

Senator BAUCUS. I am glad that you crept close to intruding upon another committee's jurisdiction. It is very reliable data. Thank you.

Senator DODD. I will not do it again.

Senator BAUCUS. I hope you do.

Senator DODD. Particularly the Finance Committee.

Senator BAUCUS. I hope you do.

Senator DODD. Thank you very much. Anything else, Mr. Chairman?

Senator BOREN. Senator Breaux?

Senator BREAUX. No questions.

Senator BOREN. Thank you very much, Senator Dodd.

Senator DODD. Thank you very much, Mr. Chairman. I appreciate it.

Senator BOREN. I know that you must go; I see Senator Domenici has joined us. He is scheduled to speak next, and then we will turn immediately to Senator Bryan and Representative Vucanovich to testify. Did I see Senator Reid come in, or is he coming back? All right. Senator Domenici, we welcome your comments on S. 90, the Environmental Infrastructure Act, of which I am very proud to be a co-sponsor.

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM NEW MEXICO

Senator DOMENICI. Thank you. Thank you very much, Mr. Chairman and members of the committee. Let me say to the Senator and Representative who are waiting, I am going to be brief because obviously members and the staff of this committee understand what Senate Bill 90 is about, but let me just——

Senator BOREN. We will receive your full statement for the record, and all documents.

Senator DOMENICI. I appreciate that.

[The prepared statement of Senator Domenici appears in the appendix.]

Senator DOMENICI. Let me just suggest that if there is anything that is obvious in America, it is that Congress is imposing many mandates on cities, counties, and States, and we are not giving them the wherewithal to take care of those mandates. We do not have to do that. But I am not suggesting we should in all respects, because many of these mandates are health standards and are quite appropriate.

However in crafting S. 90, I looked at two national studies. One in-depth study was done at the direction of the Public Works Committee, called "Fragile Foundations, A Report on America's Public Works, National Council on Public Works Improvements." Another study was done for the Budget Committee of the Senate, called The Private Advisory Panel on Infrastructure Financing. Both of those studies focused on environmental infrastructure in the country, and on the inability of communities, cities, States, and counties to pay for that infrastructure.

What I have done in S. 90 is to take two recommendations that were made by those two panels, and have incorporated them into a very narrow bill that deals with environmental infrastructure, that is projects for water supply, sewage treatment, solid and hazardous waste disposal, and facilities needed to meet EPA standards. The bill permits municipalities to finance such facilities at the local level through fax-free bonds, lifting the cap on tax-free bonds.

Additional, these bonds would no longer be subject to the minimum tax—that is the interest that comes on those tax-free bonds. Finally, the bill encourages partnerships between the private and public sectors with reference to investing in environmental infrastructure projects.

Mr. Chairman, in current law we have permitted one tax treatment for solid waste disposal, but not for other environmental infrastructure needs. This bill allows us to go ahead and treat all types of environmental infrastructures the same for tax treatment under the Code as you do for solid waste facilities, thus permitting the private investor to get a better investment opportunity in any of these kinds of investments.

Now, frankly, I believe, contrary to what was said by the representative of the Administration—and clearly, I understand that this might cost as much as $350 million a year to the tax coffers of the country—unless and until we find a way to do that with the budget agreement that says neutrality is the thing, we just will not do it.

I believe this is a far more efficient way to deal with infrastructure needs rather than grants or other kinds of aid. It may cost us more, but we will get better facilities by doing it this way than under any grant program.

As well, we will get an injection of private sector initiative in two or three of these areas, where they will form partnerships because they will get tax benefits. Nonetheless, these will be efficient facilities, or they will not invest in them. So, I truly believe the time has come for this kind of approach to meeting environmental needs in the country. We are not going to be able to finance them any other way, and we are going to have to use the Tax Code and give our cities, States, and investors a break.

I have heard no one say that we are overloaded with tax-free bonds, and to put these on the market would negate their effectiveness. If somebody were here to say that, that would be a pretty good argument. But I do not believe there is anybody here saying that.

Senator BOREN. Well, thank you very much, Senator Domenici. Needless to say, it will not surprise you to hear that I agree very strongly with the comments that you just made. I think we all have these very important environmental goals that we want to see achieved.

Congress has legislated and mandated in many areas already; undoubtedly it will legislate and mandate in others where we need to take action. We do not deny the need to do so, but I think we must provide help to those at the State and local level to meet these responsibilities that are being placed on them.

I also agree with you that we are going to have more cost-effective and better designed programs and projects to meet the unique local needs if we let these projects operate through the marketplace rather than through the creation of an expanded Federal bureaucracy. Given the way that the budget rules now operate, we are probably not going to have such expansion anyway as the Senator from New Mexico well knows.

Senator DOMENICI. I want to thank you for co-sponsoring this, Mr. Chairman.

Senator BOREN. Thank you very much. Any comments from other members of the committee?

[No response.]

Senator BOREN. Thank you very much, Senator Domenici. Senator Pell has arrived, and Senator Graham has arrived. I have just explained that Senator Bryan and his colleague from Nevada have been here some time. I will ask all four of you to please come up to the front at this time, and we will proceed.

Since Senator Bryan and Representative Vucanovich have been waiting for some time, let me allow them to make their brief opening statements, and let me say again, we will receive your full statements and any supporting documentation for the record. And then we will immediately proceed to Chairman Pell and to our colleague, Senator Graham, to talk about the boat tax, proposal S. 649.

So, at this time, Senator Bryan, we would welcome your comments about S. 267, and the comments of your colleague in regard

to the pension and retirement income provisions of that particular bill.

STATEMENT OF HON. RICHARD H. BRYAN, A U.S. SENATOR FROM NEVADA

Senator BRYAN. Mr. Chairman, I thank you very much, and I appreciate your courtesy in arranging for this hearing today.

As you have indicated, I am here testifying in support of S. 267, legislation introduced by Senator Reid and myself, to eliminate the State source income tax on retirement income.

Later this afternoon, you will be hearing testimony from Mr. Bill Hoffman of Carson City, Nevada, who is here to testify on behalf of his group, RESIST. RESIST has been an extremely effective group on bringing this issue to the attention of not only the Congress, but the American public.

As we all know, many individuals choose to retire to States other than those where they spent their working life. There are many reasons for such moves, and I think all of us could agree that retirees ought to have the right to live wherever they choose.

As Mr. Hoffman will describe in greater detail, many retirees are not allowed to break their ties to their former State. These individuals are not allowed to vote or receive services in their former State. Nevertheless, they are forced to pay their former State income taxes on their retirement income.

In Nevada, approximately 100,000 retirees face this unfair and burdensome taxation. While this problem is especially acute for retirees who move to States like Nevada, which collects no State income tax, the injustice of this taxation without representation should offend all of us.

In addition to placing an undue burden on retirees who choose to move to a different State, the source taxes restrict the new State's ability to raise revenues, even though the new State is now charged with the responsibility of providing services to the retiree.

While none of us enjoy paying taxes, most of us understand the necessity for taxes, with two major caveats.

First, we expect to have some sort of control, no matter how indirect, over the decision-making process regarding both the assessment of the taxes, and the spending of the associated revenues. As we all know, this is the very principal upon which our Nation was founded.

Second, we expect to receive some sort of benefit from the taxes we pay. The victims of the source tax have neither the control, nor the benefits of the taxes which are collected by their former States.

Over the past few years, I have listened to many accounts of how the source tax effects the constituents in my State. Let me just cite one that appeared in the Las Vegas Review Journal recently, and I quote, "Perhaps the saddest case is that of a 72-year-old Gertrude Eberly, of Fallon, NV. Nine years after moving to Nevada, she suddenly was hit with a bill for $4,000 in delinquent California income taxes. Unable to pay it all out of her $13,000 annual income, Ms. Eberly agreed to pay $50 a month to California. If she lives long enough, she might eventually be able to pay off that debt."

Mr. Chairman, retirees should not be subjected to this type of abusive taxation. While there is a legitimate concern in some cases regarding deferred income and the lack of tax payments on pension contributions in the past, such situations cannot justify a life-long servitude to a retiree's former State. Settlement arranges can and should be worked out that reflect the interest of both the retirees and their former States.

I have spent most of my nearly three decades of public service at the State level. I value the right of States to govern themselves as much as any other member of this distinguished body. Nevertheless, these rights stop at the State border. Taxation without representation was not tolerated by our forbearers, and ought not to be tolerated today.

Mr. Chairman, I thank you very much for holding this hearing, and I am hopeful that we may move forward and act upon this legislative proposal.

[The prepared statement of Senator Bryan appears in the appendix.]

Senator BOREN. Thank you very much, Senator Bryan.

Representative Vucanovich, we would welcome your comments.

STATEMENT OF HON. BARBARA VUCANOVICH, A U.S. REPRESENTATIVE FROM NEVADA

Representative VUCANOVICH. Thank you very much, Senator, and I appreciate the opportunity to be here. My colleague from the Senate has made a good many of the points that I would like to make in support of S. 267. And he has also mentioned Bill Hoffman, who is in the audience, and who will be testifying later on.

So, I would just like to make a couple of comments about the companion legislation that I have in the House and make a few comments that I think are relative, and then, naturally, my comments will be part of the record, I understand.

Bill Hoffman himself came to see me quite a few years ago on this subject, and I have introduced legislation prior to this time, but again, on January 3rd of this year, in response to a growing anti-tax movement in my State of Nevada, and many other States, I have introduced H.R. 431 in the House. And both S. 267 and H. 431 would put an absolute ban on the unfair practice of taxing nonresidents pension income.

I am going to just summarize here, if I can. I think Senator Bryan has made the same point. You know, the Boston Tea Party and the Revolution occurred because of unreasonable taxation without representation. And I think Congress has to resolve this situation as soon as possible. Our seniors and our retirees deserve no more.

In addition to H. 431, which has 115 co-sponsors, I have introduced H.R. 1655, which has been referred to the House Ways and Means Committee. And this is a little bit different bill.

This bill would amend the Tax Reform Act of 1986 to number one, provide tax payers with an advance notice of the tax; second, it would use a taxing formula that does not include income from other States. And third, it would provide taxpayers an opportunity

to repay the tax before they actually leave the State. Now, this bill has 33 co-sponsors.

Mr. Chairman, I just would again say that it is important to the seniors who are out there and who feel they have enough burdens in this world without having to pay unfair income tax, and so I ask that my full statement be made part of the record, and appreciate the opportunity for this hearing. It is very important to the people I represent. Thank you very much.

Senator BOREN. Thank you very much. Certainly both you and your colleague, Senator Bryan, have done a good job in expressing the problem that people face in being harassed by the burdens and the administrative problems related to double taxation, and I think you make a good case for the need to address this problem. I am sure that it affects a large number of people——

Representative VUCANOVICH. It does.

Senator BOREN [continuing]. Who now are full-time residents in your State. So we appreciate your testimony and will receive the full statement and the back-up documents for the record.

Representative VUCANOVICH. Thank you very much, Mr. Chairman.

[The prepared statement of Representative Vucanovich appears in the appendix.]

Senator BOREN. Any questions from our colleagues of this panel?

[No response.]

Senator BOREN. Thank you very much.

Representative VUCANOVICH. Thank you very much.

Senator BOREN. Thank you for your patience in waiting this morning. Glad to have you with us.

We now are going to turn to a panel that relates to S. 649, the luxury tax on boats. Some comments have already been made in the opening statements of members about this particular proposal. Our panel will consist of Senator Claiborne Pell of the State of Rhode Island, Senator Bob Graham of Florida, Representative Olympia Snowe of Maine, and Representative Clay Shaw, Jr. from the State of Florida. We are happy to have all of you. I welcome my colleagues and welcome our colleagues from the House who are here to talk about a bill that I know is of great importance.

It has really a very strong regional impact. This is not a tax burden that is distributed evenly across the country, and it has had a very strong negative impact on the economy of certain regions of the country. So, we welcome your testimony in relation to this bill.

Senator Pell, I know you have to return to your committee responsibilities, so we will begin with your statement. I might say to all of you, before you arrived, I explained that we have close to 40 witnesses today and another hearing scheduled this afternoon.

As it was learned that we were having the miscellaneous hearings, more and more items seemed to be brought forward, and more and more witnesses wanted to testify. We wanted to accommodate them all, so we are trying to hold all of our witnesses to 4 minutes in their opening statements, taking summaries of their full statements, and all other documents for the record.

We welcome your comments, but I did want to let you know we are trying to move along because of our time constraints. I know you probably all have the same problems, as well.

Senator Pell.

STATEMENT OF HON. CLAIBORNE PELL, A U.S. SENATOR FROM RHODE ISLAND

Senator PELL. Thank you very much, Mr. Chairman, and thank you for this opportunity to testify.

At the outset, I would like to congratulate and commend my colleague from Rhode Island, Senator Chafee and Senator Breaux, for their leadership in proposing S. 649 that would repeal the recreational boat luxury tax, of which I am an original co-sponsor.

Mr. Chairman, the 10-percent excise tax on the sales price in excess of $100,000 on recreational boats was enacted last year with two objectives. One, to raise revenue. Two, to tax the rich. In reality, the tax fails in both of these objectives.

What the tax has produced in tandem with the economic recession, is a catastrophic collapse in the recreational boat industry. Rhode Island is one of our nation's leading producers of recreational boats, with a proud heritage of the great names in American yachting history—Herreshoff, Pearson and the like.

That industry in Rhode Island has now been devastated by bankruptcy, closings, and layoffs. Those in the industry of selling motor and selling yachts to the rich will tell you today that the luxury tax has played a major part in that collapse.

I have not heard one cry of complaint, Mr. Chairman, from rich yachtsmen about the luxury tax on boats. But I have heard desperate pleas for help from those whose jobs have been eliminated or threatened by collapse of boat orders and sales.

I have heard from marine architects, shipwrights, skilled workers in wood and fiberglass, engineers who have produced some of the world's greatest and most admired sailing vessels and who are now either jobless or will soon be.

Is the luxury tax raising revenue? The best informal estimates are that it will raise less revenue than the cost to the Federal Government of imposing and collecting that tax.

Is the luxury tax really taxing the rich? Hardly. Any well-off yachtsman who wishes to pursue his recreation can do so easily without paying a luxury tax. He can, for example, buy a $500,000 yacht in England, home port it in the Caribbean, sail it up and down the coast of the United States, stopping into such waters as those of my own Naragasset Bay, or the Chesapeake Bay, and he would pay no luxury tax.

Or, a well-off person can simply decide to pursue another less-taxed recreation—buy a hunting lodge, a condominium at a ski resort, maybe a string of polo ponies if he is really active, and there is no luxury tax.

In truth, Mr. Chairman, if we wish to tax the well-off we must tax their income, not their purchases.

To suggest this tax on recreation boats offsets the excise taxes imposed last year upon beer, wine, cigarettes and gasoline consumed by the average American is, I believe, absurd.

The luxury tax in boats is little more than a symbolic gesture towards tax equity, but for the boating industry workers in my own

State of Rhode Island and other seashore States, it is a symbol they cannot afford.

It is a tax that raises little or no revenue and instead of taxing the rich, imposes a crushing burden of unemployment on thousands of skilled American workers. I urge the subcommittee to approve legislation to repeal this tax.

Senator BOREN. Thank you very much, Senator Pell.

[The prepared statement of Senator Pell appears in the appendix.]

Senator BOREN. Senator Graham.

STATEMENT OF HON. BOB GRAHAM, A U.S. SENATOR FROM FLORIDA

Senator GRAHAM. Thank you very much, Mr. Chairman. I, too, appreciate this opportunity to testify on an issue of very great importance to my State.

As Senator Pell has just stated, one purpose for the adoption of the luxury tax on boats last year was to tax the wealthiest of Americans.

Instead, those wealthy Americans have decided to postpone their purchase, to acquire used boats not subject to this sur-tax, or to buy boats in another country.

All of this has caused serious damage to the manufacturers, retailers, and workers in America's boating industry, particularly in my State of Florida.

Mr. Chairman, in Florida, manufacturing and sale of recreational boats is a $3.5 billion annual industry. Since the luxury tax went into effect on January 1, this industry has been in marked decline.

A study of 17 Florida boat dealers and custom manufacturers revealed that boat sales have declined nearly 90 percent in the first quarter of 1991, as compared to the first quarter of 1990.

These retailers have had to lay off nearly 30 percent of their workers. No one can deny that the recession has had a devastating effect on the boating industry. Throughout Florida boat dealers admit that business was bad. Yet, they were weathering the recession. They cannot survive this tax. We are not talking about the demise of large, bureaucratic corporations. These retailers and manufacturers are mostly family-owned proprietorships with less than 100 employees.

This tax is also hurting cities and towns where the boat manufacturers are located. One example is Sarasota, FL, where Wellcraft Marine is located. Wellcraft, in 1988, produced more boats than it had produced in its entire first decade of existence. Last year, however, Wellcraft's employment decreased from 2,000 to 800, and two other boat manufacturers in Sarasota declared bankruptcy.

As a result of this, 4,000 people in that one community in my State have lost their jobs. This loss of manufacturing is particularly harmful, since those jobs in the recreational boating industry generate employment in other affiliated industries, such as service, supply, and outfitting.

Using the U.S. Chamber of Commerce estimate that for every 100 manufacturing jobs, a county earns $2 million in gross income.

At that rate, Sarasota County has lost $80 million as a result of the decline in the recreational boating industry. This is just one example.There are 626 boat manufacturers in our State.

This tax has had consequences throughout Florida. The marine industry has estimated that the State of Florida will lose $3.5 million in sales tax revenue for just the first quarter of 1991. As I mentioned, cities and counties are also suffering from impact of this tax.

The luxury tax on boats has not just cost jobs, it has not just cost State revenue, but as Senator Pell pointed out, it could also cost the Federal Government revenue. The Joint Committee on Tax estimates that the tax will raise only $3 million this fiscal year. That is less than the sales taxes that the State of Florida lost in the first 90 days of this tax.

On April 23, a partner at the accounting firm of Coopers & Lybland reported that the Internal Revenue Service could spend two to three times this amount on collecting the tax. Several members of Congress have requested the General Accounting Office to study this claim.

These administrative costs, combined with unemployment compensation, lost corporate and payroll tax revenues, could mean that this tax will actually result in a loss in Federal revenue.

While Americans are losing money, Bahamian boat builders are seeing profits soar. Rather than pay a 10-percent tax in West Palm Beach, a yacht buyer can take a 20 minute flight to the Bahamas. In fact, Bahamian Prime Minister Pindling recently cut import taxes specifically to encourage such purchases.

It is obvious, Mr. Chairman, that people are suffering, and those people are not the luxury yacht buyers. They can wait to buy their yachts. The workers, the manufacturers, the retailers cannot wait.

It is important that Congress move quickly to repeal this tax. I wish to commend our colleague, Senator Breaux, for his leadership, as well as my colleague, Congressman Shaw for his. I hope that others will join as co-sponsors and that this misguided proposal will soon be repealed.

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much, Senator Graham.

[The prepared statement of Senator Graham appears in the appendix.]

Senator BOREN. Representative Snowe.

STATEMENT OF HON. OLYMPIA SNOWE, A U.S. REPRESENTATIVE FROM MAINE

Representative SNOWE. Thank you, Mr. Chairman, and members of the committee. Chairman Boren, I certainly want to express my appreciation to you for giving us this opportunity to testify on behalf of legislation to repeal the 10-percent excise tax on boats costing more than $100,000. I can only say that this legislation is critically important to the people I represent in Maine.

And as others have mentioned here today, the fact is while the goal was commendable in terms of making sure that high-income taxpayers continued to pay their fair share, what has happened in

the boat-building industry in the State of Maine is that highly-skilled blue-collar workers are being put out of their jobs.

According to the Maine Marine Trade Association, there are 24 companies in the State of Maine that build recreational boats for more than $100,000. These businesses directly employ 500 people in Maine. In addition, this tax has affected other boat builders who build boats for less than $100,000.

The 500 Mainers who are employed in these boat building industries, half of them have lost their jobs, or the other half, their jobs are at risk. There is no question that there has been a slump in the industry, and what has happened with this 10-percent tax, it has sent the industry in a freefall.

This is happening, as has been mentioned here today, because few boat orders are being placed. Indeed, the June 1991 edition of "Trade Only," a Marine Trade publication, reports that sales of boats costing more than $100,000 have fallen 86 percent from last year's levels.

It is clear that the revenues projected under this 10-percent tax will not be realized. Obviously, compounding the problem will be the increased cost to the government from the loss of income taxes because individuals are being laid off, as well as increased costs in unemployment compensation.

I would like to give the committee several examples of what has happened in the State of Maine, in particular in my district, as a result of this 10-percent tax.

Earlier this year, one well-known boat building company in Maine let go 10 percent of his work force. In addition, he required the remaining 135 workers to take a 10-percent cut in pay. This same firm only had one boat order this year. And the only reason he had a boat order is because the company was willing to pay the 10-percent tax.

There is another family-owned company in East Boothbay Harbor that has been in operation for more than 160 years. Their business has been so bad that they have had to lay off 11 employees of their level of employment of 20, down to 9.

A custom boat building company in Southwest Harbor has suffered such a decline in sales, they used to employ 40 people; they are not only employing 13.

Another boat builder has had four orders for boats put on hold because the customers have said specifically because of the tax. As a result of putting those orders on hold, they have had to lay off half their work force, and plan to lay off the other half if business does not pick up soon.

Finally, there is a boat building company in Trenton, Maine, recently filed for Chapter 11 bankruptcy protection from its creditors, is trying to reorganize itself, but is saying that the luxury tax is a barrier to speedy recovery.

I might note that in Maine many of these boat building companies are small, family-owned, held for generations. They are in coastal towns along the rocky coast of the State of Maine. Building boats has been a way of life, and it is not a 9-to-5 job.

All I am asking is consideration by this committee for swift repeal of this legislation. I cannot impress upon you how devastating it has been to the small boat building industry in the State of

Maine, that really, most coastal communities are characterized by it, and thousands of jobs are indirectly affected by what is happening to that industry. That is why I am co-sponsoring the legislation that has been offered by the gentleman from Florida, Mr. Shaw, and I appreciate his leadership on this issue.

Mr. Chairman, as we try to affect the wealthy, what we have done is hit the low to middle-income workers. As one boat building in Maine said very succinctly, he said, "These rich guys don't need to own the boat as bad as we need to build them." I think he sums it up very well. The recession in Maine is tough enough without piling this on, so I urge you to defeat this 10 percent-tax.

Thank you, Mr. Chairman.

[The prepared statement of Representative Snowe appears in the appendix.]

Senator BOREN. Thank you very much. I think you make a good point about the need to look at the revenues collected in a non-static fashion. The revenues are not collected if sales are not made; moreover we have to offset the costs of unemployment and other benefits, as you have indicated.

Representative Shaw, we are very glad to have you with us today, and we would welcome your testimony.

STATEMENT OF HON. E. CLAY SHAW, A U.S. REPRESENTATIVE FROM FLORIDA

Representative SHAW. Thank you, Mr. Chairman. And I would like to add my voice of appreciation for this committee to hold these hearings. I am hopeful that my committee on the Ways and Means Committee will hold hearings in July upon this same subject.

Mr. Chairman, I have a full statement that I would ask to appear in the record in total.

[The prepared statement of Representative Shaw appears in the appendix.]

Representative SHAW. Mr. Chairman, I think probably last October, as we very often do prior to election—and no party can point the finger at any other party with regard to having a complete franchise on making mistakes—but in the speed of making legislation, sometimes political considerations are put out in front of practical considerations.

This is exactly what happened with the imposition of this boat luxury tax, which is, I think by all accounts, an absolute disaster. This year, it is estimated that some $2.7 million will be collected in the entire year on this tax. It does not take any of us who have served around here any time at all to realize that it is going to cost far more than that for the Federal Government to collect this tax. It is a total loser.

Some time ago, the National Marine Manufacturing Association made a prediction that this tax would put 8,000 out of work. That 8,000 people would have paid, had they have had their jobs, some $30 million in income tax. However, Mr. Chairman, Senators, those predictions are wrong. They are going to be closer to 19,000 people put out of work because of this tax.

The American marine manufacturers employ, in this country, 486,000. Now, when you start thinking about what industry employs what people, the steel industry employs half that amount. So, the marine industry is twice as large as the steel industry. Now, can you imagine, all hell would break loose in this Congress if we were all of a sudden to put a tax on American steel produced.

Now, the question is, who gets hurt with all of this? The people who are losing their jobs. They are the ones that are getting hurt. Sure, these big companies are going out of business. And sure, we are concerned about that, because this industry contributes to the trade surplus of this country of over $600 million just last year.

Now, what is going to happen with the domestic industry going away is that we are going to lose our world leadership position in this particular area. And when we are looking at such things as critical to the future of the United States as our balance of trade, it does not take a rocket scientist to figure out that the marine industry is a very important component in that particular area.

Just a couple of weeks ago, I visited Dennison Marina, which is a mega-yacht manufacturer in the city of Fort Lauderdale. In doing that, I talked to a young man by the name of Robert Holloman. He is a gentleman who is a skilled mechanic. He has a fourth grade education. He has one leg. He is a very productive citizen. He is very concerned.

Let me tell you what he has told me, and this comes from the transcript in which he prepared on NBC News just a week or two ago. He said, "The boat business is worse than it ever was. Yeah. I'm worried. What am I going to do tomorrow? We're really slow here right now. We're losing money. The jobs are going away. There's nothing happening."

Now, what the Congress has done—and we make mistakes, we did it on catastrophic health care, and we were big enough to reverse that. What the Congress has done is imposed a tax where they took a shot at the rich, they missed the rich, and they hit the working man right in the pocketbook. Now what is a guy going to do who has developed his skills in the marine industry, with a fourth grade education, he has got a couple of kids, he has got a mortgage, and he could very well lose his job. Dennison Marina has five boats right now that they are completing the manufacturing on, but they do not have one order that was taken this year. This is all from before the tax was imposed.

Senator Graham, I think, made a very good point, as this is exactly what is going to happen, is that business is going to go to the Bahamas. If you buy a boat outside of the United States, I do not care how many hundreds of thousands of dollars it is, as long as you keep it in the Bahamas you escape the tax. Let me read you something that happened.

Now, this is something our research told us about Congress levied a 10-percent tax on boats revenue for World War I. Then it repealed it in 1924. This is taken from the text of the hearings. "The tax upon the sale of yachts is a great burden to yacht builders of this country, since it forces persons to purchase yachts outside of the United States from foreign manufacturers in order to avoid the tax." That tax, of course, was repealed.

This is a destructive tax, Mr. Chairman and members of the committee. I would hope that you would join with Senator Breaux and the other sponsors and co-sponsors of this particular bill, repeal it here. And I hope and pray that we will follow suit over in the House. It does nobody any good at all.

Senator BOREN. Thank you very much. And again, you certainly make a strong case, both in terms of the facts concerning the domestic economy, and as Senator Graham said earlier, the loss of a lot of this industry to the United States and the danger that it will move off-shore.

Questions, members of the committee, of this panel?

Senator Breaux?

Senator BREAUX. Just very quickly, I want to thank the panel and thank our House colleagues for coming over, and also remind them that you have to send us something over here in the form of a tax bill so that we can add this little measure to it. So, we are anxiously awaiting something coming over from the House in the form of a vehicle, certainly, for us to work with.

You might not have been here for the testimony of our first witness this morning, Ken Gideon, Assistant Secretary for Treasury. I had asked him how long is it going to take for them to give us a report on the effects of the tax, and their response was, well, probably 2 to 3 years.

And I think you would all agree that we are not going to have an industry left in 2 to 3 years if we have to wait that long to get the reports from the Treasury Department.

Representative SHAW. Senator, if I may comment on that, Robert Holloman, and so many like him all across this country from Maine to Florida, all the way to the West Coast, they do not have time. Their jobs are on the line; they are going to lose their jobs.

Senator BREAUX. Well, I think you all have made an excellent presentation. I think the consensus is that Congress misfired, and not only did we miss the target, we hit ourselves and a lot of the people that really need help and not any extra tax burdens. We have made these mistakes before. It is easy enough to correct it. And the estimates on the revenue for the first year, possibly of $3 million certainly is not worth what we are doing. Thank you, Mr. Chairman. Thank you, panel.

Senator BOREN. Senator Bradley.

Senator BRADLEY. Mr. Chairman, let me thank the panel very much for their testimony. I think they raised some important points, and I know you and the committee will want to look at it very carefully. I certainly want to look at the testimony very carefully and make a judgment.

Senator BOREN. Thank you very much. I appreciate the testimony from all members of the panel. Thank you for joining us.

The next panel relates to a bill which has been introduced by Senator Bradley, a fellow member of this committee, S. 284, the Living Benefits Act to amend the tax treatment of payments under life insurance contracts for terminally ill individuals.

Senator Bradley, you have joined us since we have commenced the hearing today, and you might well want to make some opening comments about this matter. We would welcome them, and then

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we will turn to our friend and colleague, Senator Lieberman, to testify on this matter.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator BRADLEY. Mr. Chairman, I thank you. I would just like to get on with the hearing. I think that it was very interesting that Mr. Gideon testified earlier that he was for capital gains, but against assisting the terminally ill, and I think that is a very interesting juxtaposition.

I think as the committee looks at this and as it hears the testimony of the witnesses today, that the overwhelming needs of the terminally ill will begin to make a real impact on the committee, and I hope that the result will be that we will be able to deliver some relief in terms of some small tax benefit for those who are suffering from terminal illness.

It seems to me this is a decision that the life insurance industry has taken on itself in a very, I think, humane gesture and action, and I think that it is only fair and just that the Congress follow suit in terms of the tax status of these living benefits.

So, Mr. Chairman, I thank you for scheduling this hearing. And I am very pleased that my main co-sponsor, Senator Lieberman, is here today. I know that he will probably have several stories. I might not be able to stay for the whole testimony, but I will be back later for the other panel.

Senator BOREN. Thank you very much, Senator Bradley.

Senator Lieberman, we are certainly pleased to have you this morning, and appreciate your taking time to come and be with us. I know this signals your strong interest in this matter, and we would welcome your testimony. Let me say we will receive your full testimony for the record.

As I have been indicating to our witnesses, we have almost 40 witnesses today with time constraints because of another hearing scheduled in this same room later on. So, we will receive your full testimony for the record, and would welcome any summary of it which you might like to present to us.

[The prepared statement of Senator Lieberman appears in the appendix.]

STATEMENT OF HON. JOSEPH I. LIEBERMAN, A U.S. SENATOR FROM CONNECTICUT

Senator LIEBERMAN. Thank you very much, Mr. Chairman, Senator Bradley, members of the subcommittee. Responding to the Treasury Department earlier, I am both for the capital gains tax cut and the Living Benefits Act, and I think that is the appropriate mix. I want to thank you for this opportunity to appear here on behalf of this idea.

The legislation quite simply amends Section 101 of the IRS Code to exclude accelerated death benefits from income if paid to an insured person who is certified by a licensed physician as being terminally ill, and expected to die within 12 months.

In addition, the bill amends the Social Security Act to insure that policyholders are not compelled to elect pre-payment of death

benefits in order to become eligible or remain eligible for Federal means-tested programs.

I am very honored to be working with Senator Bradley on this legislation, and with my colleagues, Senator Dodd, and Congresswoman Kennelly, who I believe will not be able to be here this morning.

The fact is that when individuals suffer from serious or terminal illnesses, such as cancer or AIDS, they are forced not only to confront the tragedy of their illness, but also the overwhelming economic consequences of their condition. Some of these people are in the prime of their lives, and the principal financial supporters of their families.

If they lose their jobs, or are too ill to work, their families are unable to meet the everyday expenses to cover the cost of housing, food, and other necessities of life. And often, they really do not have the resources to obtain even the necessary medical help.

Too many people who find themselves seriously ill soon find themselves destitute as well. Yet, tragically, for many of these people, thousands of dollars that they have saved carefully over the years lie just beyond their grasp at that moment of need in the form of life insurance policies.

Many Americans make life insurance their primary form of savings. In 1989, the American Council on Life Insurance found that 104 million Americans were covered by $5 trillion in individual life insurance, and 138 million people had $3.4 trillion through group policies.

Now, that is big money even around the Congress of the United States, and it is great to see that that kind of saving is occurring. This is money which could insure a terminally ill person access to needed medical care, or could make the difference between keeping their home or becoming homeless. Our legislation would allow those who have a year or less left to live to opt for pre-payment of death benefits, thus providing them with funds to pay for the enormous expenses associated with a terminal illness.

Our bill gives seriously ill people a chance to live the remaining months of their lives as normally and comfortably as possible by allowing them the opportunity to choose between receiving health care in a hospital, in a hospice, or in their home by giving them access to the medical equipment they need, or even making it possible for them to make one last trip to visit a close friend or a relative.

Pre-payment of death benefits would provide a unique opportunity to channel a significant pool of existing financial resources to those that are desperately in need, with minimal Federal cost to the government.

Terminal illnesses strike people from all segments of the population. Our bill would give such people economic flexibility and wider options to take care of their special needs as they approach the end of their lives.

For example, one resident of Florida, where a pre-payment of death benefits is allowed, who lived alone in a trailer and whose only source of income was from Social Security, received an accelerated benefit on her life insurance so she could finance a last visit

to her sister in Maryland, and she could purchase a powered wheelchair so she could be mobile.

Along with Florida, 48 other States have approved the sale of accelerated death benefits, and many insurance companies, to their credit, have taken the leadership and are now offering pre-payment of death benefits if the person insured under the policy becomes terminally ill.

But there is a gray area that remains, and that has to do with tax treatment of such benefits. And this bill of ours would clear up that gray area and allow the good work that the industry wants to occur to occur.

Mr. Chairman, finally, both Prudential Insurance Co. and Connecticut Mutual are to be commended for taking the lead in the insurance industry and proposing and crafting these policies that would allow the terminally ill access to these benefits.

I am very proud to be working with Senator Bradley and the other 51 co-sponsors in the Senate on this legislation. And I hope that we can enact it this session so that those who qualify can benefit from this provision as soon as possible.

Thank you very much.

Senator BOREN. Thank you very much, Senator Lieberman. You make a very good point, and I think there are very few of us who have not come in contact with this situation in trying to help our constituents. The moment of terrible tragedy in people's lives, and then stress for them and their families to have these additional concerns put upon them is something that I think it is imperative that we deal with. There are certain things that touch people's lives that we simply must be responsive to.

Action should not be postponed, and I join you in hoping that we can have action on this legislative proposal as soon as possible, and I commend you for your interest in it, and for joining with Senator Bradley as a member of this committee, in pushing this legislation. You have certainly given a strong testimony today.

Senator LIEBERMAN. Thank you, Mr. Chairman. I am greatly encouraged by your response.

Senator BOREN. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman. Senator Lieberman, I think that most people are probably not aware of what this bill attempts to correct. If you have a life insurance policy and you die, the beneficiaries receive the benefits of that policy, tax-free.

Senator LIEBERMAN. Right.

Senator BRADLEY. If you are terminally ill, and have been so certified by a doctor, and you cannot get any more health care or any of the many other possible needs you might have in the last months of your life, you decide to cash in, you have got to pay a tax on that.

Senator LIEBERMAN. Right.

Senator BRADLEY. And that is the issue that we are addressing with this bill, that if you are judged to be terminally ill, in the last year of your life, and you cash in, you should not have to pay a tax on what you have cashed in.

Now, the Administration raised a number of issues. One of the things they raised was the slippery slope argument. That, if you do

it for someone who is terminally ill, next year it is going to be housing. And the year after that it is going to be education. And the year after that who knows what it will be, whatever.

Do you think that is a really big problem? Do you think it is possible to draw a distinction between someone who is terminally ill and every other use that some lobbyist might dream up?

Senator LIEBERMAN. Well, of course, I think those distinctions are not only possible, but that is our responsibility. The old slippery slope argument is used by people who want to stop something that, in itself, is so commendable they cannot oppose it on its merits, but they want to get you alarmed about what might follow. And it is our responsibility and our ability to draw those lines, and I know we are perfectly capable of it. The reality that your statement makes clear is that we are talking about really a very minor change here. These folks who have paid money into their life insurance policies are entitled to the benefits of those policies, and they are going to get them—or their beneficiaries are—when they die.

Why not give them the opportunity to move up, at the maximum by a year, their opportunity to have those benefits? I do not see the consequences for the Federal Government. I think it is very, very wise use of these literally trillions of dollars of assets that are out there.

Senator BRADLEY. And it does require a doctor's certification.

Senator LIEBERMAN. Absolutely.

Senator BRADLEY. So the question about abuse—defining someone who is terminally ill, is not an impossible job. Isn't for a doctor, would you not agree?

Senator LIEBERMAN. Absolutely.

Senator BRADLEY. The Administration indicated some concern that there would be abuse. If you had measles, that the doctor would say you are terminally ill.

Senator LIEBERMAN. Yes.

Senator BRADLEY. I do not think that is a reasonable worry, do you?

Senator LIEBERMAN. I do not either, Senator Bradley. Legal definitions of terminal illness are well-accepted. Obviously, someone might make a mistake.

A doctor might conclude that someone was terminally ill and they lived on, and the worst consequence was that they would have received the life insurance proceeds they paid for anyway a little earlier than otherwise, and the benefits would not be there when they, in fact, did die.

Senator BRADLEY. And as you know, in the bill we provide that there are no restrictions on how they use the funds, because someone who is dying might have any number of needs that some of us might not understand. And do you not agree that that is a reasonable approach?

Senator LIEBERMAN. Yes, I do, because this bill and this option would cover such a wide variety of individuals with a wide variety of needs. If we start to try to limit the use of it, it makes no sense.

And again, this is something that is literally owned by the person who has paid those life insurance premiums over the course of his lifetime. And all we are saying is let him or her enjoy the benefits just a little bit earlier and do what they feel they want to

do with them. And that is the right that we are talking about. Let them live out their life in decency, as they define decency.

Senator BRADLEY. Well, Senator Lieberman, from my perspective, you have totally refuted the Administration's objections. [Laughter.]

Senator LIEBERMAN. Well, I must say that your cross examination, though withering, has——[Laughter.]

Senator BOREN. Chair was almost ready to intervene in light of the viciousness that has been going on with cross examination. [Laughter.]

Senator BOREN. But I think that it is just very difficult to quarrel with what either the witness or the cross-examiner has to say about this matter, because there is no one that has really presented any opposing testimony on the substance of the proposal.

It has simply been a matter of wanting us to defer imagined lost revenues, which would be, I think, very insignificant when we weigh the human element and the compassion that needs to be demonstrated to those people.

Senator LIEBERMAN. Exactly right.

Senator BOREN. Thank you very much, Senator Lieberman, for being with us. We appreciate your testimony. And as I say, I am hopeful we will be able to have the full committee and the Senate take action on this matter in a timely fashion.

Senator LIEBERMAN. Thank you, Mr. Chairman. I thank you for your kind words and your encouragement.

And if I may, I just want to thank personally and commend to you Mr. Dennis Mullane, who is the CEO of Connecticut Mutual, who is here and will testify before you, who has been a leader in this, an outstanding citizen of my State, and a real national business leader. And I am proud and appreciate the fact that you are going to hear him as the day goes on.

Senator BOREN. Thank you very much, Senator Lieberman.

Senator LIEBERMAN. Thank you.

Senator BOREN. Our next panel consists of several local officials. Mrs. Mary Ellen Withrow, treasurer of the State of Ohio; Ms. Kathleen Brown, the treasurer of the State of California; Ms. Kay Bailey Hutchison, treasurer of the State of Texas; Mr. Samuel Shapiro, treasurer of the State of Maine; and Mr. Stephen Kafoury, a board member of the Portland Public School District in Portland, OR. We are very pleased to have all of you with us to testify. I know some of you will be testifying on S. 90, the Environmental Infrastructure Act. Some will be testifying on S. 913 relating to Tax-Exempt Bond Simplification Act, the Baucus proposal, and some of you undoubtedly will have comments on both.

As I indicated earlier, we are particularly glad to have this input from those in State and local government who are trying to meet the responsibilities that have been thrust upon you. I know from my own experience of trying to balance State budgets and local budgets that it is not an easy task these days with additional mandates imposed by Federal Government.

I always had strong feelings about the Federal Government being very "helpful" in the area of mandating all of the things we needed to do, making those judgments for us, but then providing us

no ability to pay for it, and often further reducing the capacity that we had previously.

When we talk about reducing the ability of financing tax-exempt bonds with less burden at lower cost, we particularly hurt those States that are in the position of having to borrow because they sometimes do not have adequate financial resources. We make it even more difficult for them to meet those responsibilities.

This was a matter that I felt strongly about at the time that the 1986 Act was passed, and I opposed the Act. I am very glad to see these proposals for some remedial action. Let me ask members of the committee: Senator Packwood, you have a witness in this group. I do not know if you have any opening comments. You have joined us since we heard opening comments.

Senator Baucus has made some opening comments. This panel does touch on his legislative proposal. Before we begin the panel, let me just ask my colleagues if they have any introductory comments they would like to make.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. I am an old friend of Mr. Kafoury's. He has been an active Democrat for years, and he and I are on opposite sides of the fence in many matters. But he is the epitome of a good citizen, and has probably given as much time to public service as anybody sitting up here on the rostrum, and is exactly what you would hope a great citizen would be. And now I do not know how much time he gives on the Portland School Board, but he does not get paid for it.

Senator BOREN. I am glad my colleague from Oregon has described the typical member of the Democratic party here today—

[Laughter.]

Senator BOREN. Who exercises this kind of civic responsibility. We do welcome you, and thank you, Senator Packwood, for your comments. Senator Baucus, any additional comments before we begin?

[No response.]

Senator BOREN. We will begin then. This is in no particular order—unless you have plans among yourselves as to how to begin. Ms. Withrow, do you have such plans?

STATEMENT OF MARY ELLEN WITHROW, TREASURER, STATE OF OHIO, COLUMBUS, OH

Ms. WITHROW. Well, I think we sort of set up the agenda.

Senator BOREN. Let us follow the order here. All right. Then we will go to Ms. Brown next, and Ms. Hutchison, and then Mr. Shapiro and Mr. Kafoury, in that order. agenda. And I may have to be out for just a moment. If I am, Senator Baucus will continue Chairing, and then I will rejoin you. But we welcome you. We value the insights that you bring to us from State and local government.

Ms. WITHROW. Thank you very much, Chairman Boren, and members of the subcommittee. I am Mary Ellen Withrow, the Treasurer of the State of Ohio, and Senior Vice President of the National Association of State Treasurers. And I want to thank the

subcommittee for the opportunity to testify today on behalf of NAST in support of Senate Bill 913.

We have heard a lot about infrastructure in our country, and I want to tell you about something that happened in Columbus, Ohio back in July of 1986 when a lawyer in his Mercedes Benz fell through the street into a sink hole that had been created by the collapse of a sewer. This was something that caught worldwide attention. He emerged unhurt, but it was disastrous because of the fact that hundreds of people travel this every day, and it is just a half a block from the Statehouse. In November of 1987, the voters of Ohio——

Senator BOREN. I wonder if any litigation flowed from this. [Laughter.]

Ms. WITHROW. I imagine there was a lot of litigation. But then in November of 1987, the voters of Ohio responded to our State's infrastructure emergency and approved an historic ballot issue. This referendum created the Ohio Infrastructure Bond Program, the nation's first infrastructure program created by an amendment to the Ohio Constitution.

This program allows the State to use general revenue as support for general application infrastructure bonds. And these bonds are issued solely by the Treasurer of State.

In the Ohio Treasury, it is our objective and our duty to make the most out of every tax dollar. Since I have been treasurer, we have earned $1.6 billion in investment earnings, which is non-tax dollars.

Some other public officials, however, see the picture differently. And why should they earn as much as they can on the investment of their bond proceeds when the earnings must go, not to their community or needed projects, but to the Federal Government?

Unfortunately, some public officials now resort to what is called yield burning. The potential of public investments is not maximized, and less is earned, and ultimately fewer dollars are rebated to the Federal Government.

But those money managers must realize that when they burn yield, the Federal Government gets burned while brokerage houses reap the benefits. There are those of us who do it right. We follow the laws that you put forth, and we try to maximize our investments.

STAR Ohio, the State Treasury Asset Reserve, is a public funds investment pool that I manage. It was started in 1986 and we now invest close to $2.9 billion of the Ohio people's public money.

Its users are Ohio governmental subdivisions. Both the 1988 and 1989 infrastructure bond issues and local bond issues, monies were placed in STAR Ohio. We have the capabilities of calculating arbitrage rebate on these bond issue earnings at no cost to the shareholders.

But today, we ask you to remove some of the roadblocks that Congress has placed in our way in addressing our problems. Specifically, we ask you to support Senate Bill 913, to support increasing the small user exception to arbitrage rebate from $5 million to $25 million, and to allow the bond issuer to pay only 90 percent of the arbitrage earned as a rebate.

Permitting the issuers to keep 10 percent of what they earn in arbitrage would be a real incentive to maximize the earning potential and stop this abhorrent practice of yield burning. So, we would appreciate an even larger portion of arbitrage earnings.

And for those of us who comply fully with Federal arbitrage rebate laws, we would like to have a Federal credit back to our States in highway dollars, or other Federal funds to complete much-needed projects. This is still money that it earned by State and local governments, and it grants us the opportunity to benefit from our efforts.

It is through my membership in national associations that I have spent much time talking with my colleagues in other States, and we are pleased that you have incorporated the recommendations of the Anthony Commission in Senate Bill 913, and we ask for your support of that.

Thank you very much for this opportunity.

Senator BOREN. Thank you very much.

[The prepared statement of Ms. Withrow appears in the appendix.]

Senator BOREN. Ms. Brown.

STATEMENT OF KATHLEEN BROWN, TREASURER, STATE OF CALIFORNIA, SACRAMENTO, CA

Ms. BROWN. Good morning, Senators, Mr. Chairman, distinguished members of the committee. My name is Kathleen Brown. I am Treasurer of the State of California, and I am here today to urge your support of S. 913, the Tax-Exempt Simplification Act of 1991.

There are some who might argue that a Tax-Exempt Simplification Act is an oxymoron, and while arbitrage rebate, small-issuer exemptions and yield restrictions may not rise to the level of the evening news top story, nor present very many photo opportunities for newspapers around the country, it is, indeed, a subject of tremendous concern and importance to State and local government finance officials. And I would like to explain why.

California, as you may have read, is in a bit of a fiscal crisis, not unlike many States across the country. Ours approaches $14.3 billion this year, and our legislature and Governor are grappling with that problem right now.

Not as well-known is our infrastructure crisis. Our major roads are more often than not in gridlock. Workers cannot get to work on time, and businesses have trouble getting their goods to market. While we do not have bridges that have collapsed, such as they had in Mianus, CT, nor do we have bridges yet that have been closed, such as Williamsburg Bridge in New York, but L.A. had its version of the Ohio sewer swallowing car just a few years ago, and it may be the kind of subject that some Hollywood "B" movie production company may want to make a film, about, but we can top that with our earthquake horror stories following October 17th, 1989's "little big one." Suffice it to say for the committee's purposes that thousands of our public buildings are not seismic safe in earthquake country.

And then there are our schools. We have more than 200,000 new students each year, which means we will have to build 11 classrooms 365 days a year for the next 10 years simply to keep up.

And then there are our water supplies. They have been depleted through drought and freeze, and impacted by our significant population growth. In fact, our infrastructure crisis is as much a product of rapid growth as it is of old age.

We have 30 million in population today, and expect about 35 million citizens by the end of the 1990's, nearly 7 million new citizens since 1980, which means that our transportation systems, our schools, our prisons, our water support systems, must support the use of a new population base the size the size of Delaware, Arkansas, and Oklahoma combined.

Federal resources to help meet these needs have dwindled since the 1960's, as Senator Dodd testified earlier. And State and local governments are undergoing the severe effects of our recession. Thus, tax-exempt financing, with its lower debt service costs, play an increasingly important role for State and local governments as they attempt to finance their public works needs.

And my goal as Treasurer is to insure that our limited resources go to actual project needs to build roads, classrooms, sewer pipes, and to provide the bricks and mortars for building.

The problem has been that the Federal arbitrage and rebate compliance requirements are a prime example of the kind of administrative burden which provide full employment for accountants and lawyers at taxpayer expense, without adding any real value to the taxpayer investments.

Rules originally intended to curb abusive financings, well-intentioned, have had a series of unintended consequences which have created a new Excedrin arbitrage headache.

For example, the State of California did not issue any GO (General Obligation) bonds for more than a year after the effective date of the 1986 Tax Reform Act, in spite of the fact that our voters had voted for over $7 billion in bonds for infrastructure. It took the State that long to come up with a fail-safe method of compliance.

And that best method that we came up with resulted in eight new employees in the Treasurer's office, and five in the Comptroller's office simply to monitor arbitrage rebate compliance.

And that best method has cost taxpayers more than $30 million a year in added interest costs, because of the method we had to use. I could go on to cite examples of local government agencies in similar predicaments.

I urge your support for S. 913. It will save taxpayer dollars, it will help build infrastructure, and it will, I believe, redound to the betterment of the economy across our Nation.

Thank you very much.

Senator BOREN. Thank you very much, Ms. Brown.

[The prepared statement of Ms. Brown appears in the appendix.]

STATEMENT OF KAY BAILEY HUTCHISON, TREASURER, STATE OF TEXAS, AUSTIN, TX

Ms. HUTCHISON. Senator Baucus, I am Kay Bailey Hutchison, the State Treasurer of Texas.

Since Kathleen and Mary Ellen have talked about infrastructure needs, I think that I will just say that Texas also has very large infrastructure needs. But I would like to focus on some of the added costs that have been on State and local governments by the Tax Act of 1986.

Construction bond issuers must often split what could be one bond issue into two or more in order to insure that proceeds will be spent in accordance with the 2-year spend out schedule.

They may also issue more frequently to comply with the requirement that no more than 25 percent of bond proceeds be spent on equipment. These additional sales increase costs of issuance.

For example, a State agency regularly finances the design and construction phases of projects separately in order to comply with the 2-year spend out schedule. This practice cost them approximately $80,000 in additional issuance cost during the last fiscal year.

A university in Texas will regularly issue notes for the construction of several projects at once. However, to comply with the requirement that no more than 25 percent of an issue be used to purchase equipment, they must often purchase additional bonds, even when bond proceeds are on hand. These additional bonds are issued to handle equipment purchases which, if purchased from bond proceeds on hand, would take them over their 25-percent limit. This practice cost that university $50,000 over the last fiscal year.

The second area I would like to speak to is the complex and lengthy regulations of the Tax Reform Act which are not able to be complied with without the assistance of financial advisors, bond counsel, and accounting firms.

There are also significant costs to States and localities for internal tracking systems which must be created for compliance. The State Treasury, on behalf of two State bond issuers, is paying an outside consultant to calculate arbitrage rebate; approximately $35,000 per year for 33 bond issues.

Another State agency paid $93,000 in one fiscal year to outside consultants to create a tracking system and perform the calculations. Their costs will likely be $20,000 per year for future annual calculations.

Another Texas city is paying $29,000 per year for internal record-keeping costs and calculation of rebate by outside consultants. Still another city spends $10,000 per year for the man-hours needed to maintain the necessary internal records.

The third area is the arbitrage rebate regulations. A Texas issuer sold over $300 million in bonds in 1983. The outstanding bonds carry coupons ranging around 10 percent. With current tax-exempt rates at 7 percent, the refunding of the outstanding debt could produce substantial savings.

But due to the rules which would impact the refunding, the issuer is not going to refund the outstanding issue, because they cannot produce savings because it would make that issue now subject to the arbitrage and rebate regulations of 1986.

It is these expenses, in addition to the loss of investment earnings which must be rebated to the Federal Government, which make financing processes more difficult and costly. This makes it

even more difficult for States and localities to provide the needed infrastructure, which you have heard about today.

In addition, my State Treasury is now providing a service requested by localities to invest in tax-exempt funds in order to avoid having to calculate the arbitrage and rebate provisions so that even in some instances, they are looking at negative arbitrage just for the convenience and ease of added expense to be avoided. I would like for you to support S. 913 in the hopes that you can put my tax-exempt fund out of business, and make it profitable for the States and the Federal Government to earn the amount that is now in arbitrage and is being frittered away and not helping any of the taxpayers of America.

Thank you.

[The prepared statement of Ms. Hutchison appears in the appendix.]

Senator BAUCUS. Thank you, Ms. Hutchison.

Mr. Shapiro.

STATEMENT OF SAMUEL SHAPIRO, TREASURER, STATE OF MAINE, AUGUSTA, ME

Mr. SHAPIRO. Mr. Baucus, Mr. Packwood, thank you very much for remaining, and the staff as well. I am Sam Shapiro, Treasurer of the State of Maine, and I am in my sixth term as Treasurer. And I am going to talk to you about a very narrow issue that we are asking an amendment to the bill. It is an issue that refers to the municipal Bond Banks.

And we do things a little differently in Maine, perhaps, than they do in other places. I had a staff of 15 when I became Treasurer in 1980. Today, I have a staff of 11. When the Tax Act went into effect, we were first to issue a bond anticipation note in January.

We have already rebated excess arbitrage, and did it immediately. We obey the law. And as some of the Senators themselves admitted, you do make mistakes, as someone said in the boat tax, and I think you have made a mistake in how you effect these municipal Bond Banks.

Let me tell you about Monmouth, ME; Kennebunkport, ME. SAD-47, SAD-49. Let me tell you about small sewage districts and water districts, who issues small amounts of debt. Hundreds of thousands of dollars, sometimes a million or two. We pool them in our municipal Bond Bank. And because they are pooled in the Bond Bank, they are treated different than as if they borrow that money on their own.

They are treated differently when the pooling of those monies are more than the $10 million, they no longer have the ability of bank eligibility, or bank deductibility, which would further decrease the cost of their borrowing. When there is bank eligibility and bank deductibility, the banks are able to deduct part of their carrying costs.

So, in essence what you are doing, you are penalizing small issuers who go into a pool, and the reason they go into a pool, obviously, is because their lower costs of selling the bonds, one bond council fee, and one underwriting fee, one spread, as such.

So, I think that it so unfair, so unfair to these small issuers just because they are being pooled, that they are treated differently than they would be if they went out and borrowed it on their own with costs that would be greater to them.

And there is no benefit that I can see, or costs to the Treasury. Treasury's argument, as I understand it, is that, well, you are already getting a break by being a part of a pool and getting a lower interest cost. Why do you need a further break? And that is asinine—and you may pass that word to the Treasury—and I have called them worse over the years.

I think that long ago, several hundred years ago, they put together a Constitution. And somebody in their great wisdom said every State will have two Senators. No matter how big they are, no matter how populous they are, no matter where they are.

And I do not have to give you a lesson in government; I think you could give me one. But you know why they did that; to protect States' rights. And somewhere back in 1986, you all said—the ones I have talked to—that is bad, we really did not mean to do that, but we had that package that we had to put together.

And you did some things in that package that you wish you had not, I am sure. And now I hope you will be able to change that. And I will finally read something that somebody brighter than me put together, rather than what I have to say myself.

I have attached to my written statement draft legislation designed to prevent local issuers from being penalized by virtue of their participation in a Bond Bank issue. The legislation is tightly drafted to prevent abuses that have, at times, been perceived in some Bond Bank programs. The language requires a matching of dollar amounts, maturities, and debt service between Bond Banks and local banks, and is designed to afford the local borrowers both the lowest possible borrowing cost, and the other benefits of participation in a Bond Bank program. We believe that what is good for cities benefits States, and what is good for States benefits the Federal Government. And hopefully, you will give serious consideration to bank deductibility legislation.

And, in closing, there are Bond Banks in Texas, Alaska, Michigan, Vermont, New Hampshire, Indiana, and Colorado. And I think this would be a help to poor little Monmouth and Litchville, ME.

Thank you.

[The prepared statement of Mr. Shapiro appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Shapiro.

Mr. Kafoury.

STATEMENT OF STEPHEN KAFOURY, BOARD MEMBER, PORTLAND PUBLIC SCHOOL DISTRICT #1, PORTLAND, OR

Mr. KAFOURY. Thank you, Mr. Chair. Senator Packwood, I appreciate your kind comments.

My name is Stephen Kafoury. I am here representing the Portland, Oregon School Board. I am immediate past President of the Oregon School Board Association, and I am here also representing the National School Board Association; over 97,000 local school

board members across this country. I would like to make a few points.

Number one, Oregon law precludes the issuance of arbitrage bonds. Oregon school districts rely on property taxes to fund the cost of providing public education to our students.

The annual operating budget of Oregon school districts is subject to a local property tax cap passed last November, which will substantially reduce the amount of money available to school districts over the next 5 years, despite the fact that we anticipate significant increases in enrollment, personnel, and education programming.

Facility construction and building improvements are not subject to this cap. The projects are financed by voter-approved general obligation bonds. Because that is so, Oregon school districts are effectively precluded as a matter of law from issuing arbitrage bonds, or using the proceeds of tax-exempt issuances, including arbitrage, to fund any project other than those which satisfy the facility construction and improvement definition contained in the Oregon Constitution.

Second, education benefits of S. 913, the Tax-Exempt Bond Simplification Act of 1991. In Oregon, as in many other States across the country, the cost of school district compliance with the current arbitrage rebate rules, must come directly from funds which would otherwise be used to fund education.

In that regard, we believe that the bill you consider today would go a long way toward insuring that the interest of students' school districts in the Federal Government are both furthered and preserved.

This is true for several reasons. First, small-issue rebate exemption, removal of disproportionate regulatory costs. Increasing the small-issuer rebate exemption from $5 million to $25 million will provide relief to over 7,000 small school districts in our country that are at least able to understand and pay the cost of compliance with over 234 pages of complex Treasury Department arbitrage rebate regulations and penalty requirements.

For example, this provision would have been of significant benefit to the Beaverton, Oregon School District which, in 1988, issued a bond to finance the cost of facility construction. Properly sized at $13.8 million, the bonds were issued at the commencement of a plan design for the facilities. Nevertheless, because the proceeds were invested and paid out over the term of the construction contract, the district was required to pay rebate.

The district, as a result, spent over 100 hours of management, and 250 hours of clerical time on compliance activities; purchased computer software for $5,000, educated auditors in how they arrived at their rebate costs, and paid to the Federal Treasury a rebate in excess of $512,000.

Alternatively, enactment of this provision in 1991 would assure that at least a portion of the $250,000 to $300,000 rebate the North Clackamas School District estimates it will cost to pay on a $22 million issue to fund the cost of constructing new buildings will be available for construction maintenance and equipment upgrades.

Small-issuer Bank Interest Deduction. Increasing the small-issuer bank interest deduction exception from $10 million to $25

million would simplify and reduce the cost of borrowing for small school district users by allowing them to borrow directly from their local bank, rather than incurring the additional costs associated from borrowing from the bond market.

In addition, the National School Board Association believes that increasing this exception will have a positive political impact on local taxpayers who understandably would rather their local tax dollars be invested in their own community, supporting the local economy.

Retroactive Rebate Provisions. Third, this legislation would make the rebate relief provisions contained in the 1989 Omnibus Budget Reconciliation Act retroactive to bonds issued after August 31, 1986. The National School Board Association believes that this provision is needed to assure that districts which issued bonds prior to enactment of the 2-year rebate exception are not penalized in their efforts to comply with rules that Congress has expressly recognized as unworkable.

Fourth, the bill would repeat the 5-percent disproportionate or unrelated use restriction. We believe that, with respect to the facts that were obtained in the local school districts settings, this rule serves no legitimate purpose. That is, although certain portions of a local school district may be available for pre-arranged use by the public—for example, our gymnasiums, our tennis courts, or theaters—State laws operate to preclude the private sector from owning an interest in school district property.

Finally, legislation would require that school district users pay only 90 percent, rather than 100 percent, of rebate. As the committee is aware, it is exceedingly difficult to accurately determine the rebate that will be due and owing at the termination of a project. This is particularly true when bond proceeds are used to fund projects at a number of different sites.

Because that is so, the National School Board Association believes it is important for Congress to recognize and address this inequity which flows from a rule which requires school issuers to pay 100 percent of rebate by extending this 10 percent "safe-harbor" to school districts.

Thank you very much for your time. I appreciate your having us here.

[The prepared statement of Mr. Kafoury appears in the appendix.]

Senator BAUCUS. Thank you very much, Mr. Kafoury. I will first turn to Senator Packwood.

Senator PACKWOOD. Mr. Chairman, I have no questions, but I will comment on what Mr. Shapiro has said. I remember when we put this provision in the 1986 Act, and I remember why. Both Senator Moynihan and Senator Baucus were a part of that. There were grave abuses. We almost found—not quite, but almost—issuance of bonds that would give you the impression they were issued for the sake of making money. I understand they were not, legally. It was a tremendous drain on Federal revenues.

So, we asked any number of groups that were knowledgeable about municipal bonds and how we should correct the abuse. But, as I have discovered so often, where there is something in the law that favors some group and you are asking the group to trim it a

bit, they are hesitant to give you any advice at all. There is probably a tremendous problem within associations that have to give the advice as to being the one to step forward.

So we painted with a broad brush, and we clearly painted too broadly. I think the case you have made today is absolutely exemplary, and I, being one of the principal authors of the 1986 bill, will support you.

I just want you to understand how it happened. We saw an abuse and we did not know quite how to close it. Those who, perhaps, were unintended beneficiaries of the abuse were enthusiastic to tell us how to close it. So we went ahead and closed it. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator. I was going to basically make the same point. I think it is clear that the 1986 Act just went too far to correct some perceived abuses, and some actual abuses that occurred prior to that time.

I take it that nevertheless, you are willing to live with some of the restrictions that are contained in this bill. That is, this bill does not put us back to pre-1986 insofar as there is still a 10-percent limit on the arbitrage. Are you willing to live with that 10-percent limit that is contained in this bill?

Ms. WITHROW. I know how much the Federal Government is interested in what happens to the States, and you allocate money in other ways. And I guess maybe that was the reason in my testimony that I said if this would be earmarked back to the State for a specific purpose, such as infrastructure, or highways, or whatever, that that was the purpose for my testimony on this. It would make it more of an incentive for those of us that invest public dollars to try to maximize it as much as we can.

I never had any idea anyone would come up with yield burning when this came about, either. So, I guess we were both surprised with what happened with trying to correct the abuses, and I can sympathize with that.

Mr. SHAPIRO. Senator Baucus, might I say this. That Rome did not fall in a day. And what happens to Bridgeport and New Haven, and other cities, soon will happen to States, and you have a difficult job.

You somehow have to balance that scale that takes care of the Federal Government's needs, full well knowing that the Federal Government is made up of cities, and towns, and States. And what has worked for 200 years has been changed. If I were sitting up there, probably I would have voted like you did, if there are abuses.

But there are less abuses in our Treasurers, who I know—and if you notice, I am the token male here, by the way; that is why I am here. But these people do one heck of a good job, and I have yet been in a group of State Treasurers where they have sat around and tried to figure out some way to schnook the Federal Government out of money. It just does not happen. We care about the Federal Government, but we have a responsibility to care about our States first.

Senator BAUCUS. But to re-ask the question, you are basically saying that in return for repeal of 1986 provisions, you are willing to live with a 10-percent limit on the arbitrage.

See, the problem in the past, obviously—at least as perceived by the Congress—was that a lot of the arbitrage was abused, and it is difficult for this committee to enact precise limitations, because that got them the problem that you are now facing. So, in return, there is a 10-percent limit. But what you are saying to this committee, as I take it, that is fine. That the 10-percent limit is fine compared with all the restrictions and burdens, and the 243 pages of regulations, and so forth that prevent you from going ahead.

Mr. SHAPIRO. Yes. In short, yes, I am.

Ms. HUTCHISON. Senator, I would just like to say I do not think 10 percent is enough. I understand how bills are worked together to try to come up with what is doable, and I think this is a great step in the right direction.

But it is really a 90-percent restriction, still, and a lot of the 10 percent is going to go to the cost of calculating the arbitrage rebates.

So, I would like to say I wish it were more, and I do not want to be silent when you ask the question directly.

Senator BAUCUS. I appreciate that.

Ms. BROWN. And I would second my colleague's comments from Texas, Ohio, and Maine. Ten percent is a first step, but relief—I think a greater incentive to create more earnings for the Federal Government in the arbitrage arena would be a 15 percent-retaining number in percentage. But 10 percent is certainly welcome as an incentive. I think a greater percentage would more successful.

Senator BAUCUS. Yes. I appreciate very much your testimony. You have come great distances, and have very compelling cases to make. And they are just examples, frankly, of many others that could be made around the country, as well. I just thank you very much for your support of the bill.

Ms. BROWN. Thank you.

Ms. HUTCHISON. I would like to just make one final comment. If Mr. Packwood is going to help us on this, I would not want you to use Mrs. Withrow's suggestion as an example, because I am afraid if people in Texas thought that we could use a few more lawyers in potholes, they might never approve another bond issue. [Laughter.]

Senator BOREN. Closing on a very strong argument, I must say. I thank the panel, and I apologize that I was called away through part of the discussion. We appreciate your input, and other members of the committee will want to read the hearing record from these witnesses.

Let me say also that I wish to submit three questions that will be put to committee staff and to Senator Bradley on S. 284. I will not take time to ask them now.

Senator BAUCUS. Mr. Chairman, would you also do that for Senator Danforth, who has a statement on S. 150?

Senator BOREN. I would be happy, on S. 150, also to submit the statement for the record, and any questions or matters that Senator Danforth might wish to submit on this question.

[The prepared statement of Senator Danforth appears in the appendix.]

Senator BOREN. Our next panel will address S. 150 by our colleague, the distinguished Senator of New York, Senator Moynihan. This legislation deals with higher education tax-exempt bonds, and

would treat bonds issued for Section 501(c)(3) organizations in a manner similar to government bonds.

This panel is composed of Dr. James T. Laney, president of Emory University and Mr. Louis Katz, vice president and treasurer of the George Washington University here in Washington. We are very happy to have both of you.

When we commenced the hearing, Senator Moynihan was not with us. I would like to ask my colleague, Senator Moynihan, if he might have some opening comments that he might want to make on this legislation? Or would you like to go directly to the panel?

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. You are much too generous, Mr. Chairman. But let me just say that it is very good of Dr. Laney to appear here. It is very heartening to us to see both the public and the private institutions—if that distinction really amounts to much—coming forward on this issue.

Because at issue—at stake is the survival of something we have in the United States, and no place else on earth does, which is private institutions of higher education. If we look up in 30 years' time and find that, at the university level, private institutions have been hugely impaired, we well know it is in consequence of this simple change in the Tax Code.

The Tax Reform Act of 1986, by limiting the amount of tax-exempt finance available to private institutions of higher education, but not their public counterparts, has introduced a pernicious distinction that will work great harm.

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much, Senator Moynihan. One of my responsibilities, that I say is a privilege, is of serving on the corporation—the board of trustees of Yale University, and it has given me an opportunity to see firsthand the kinds of problems that we are facing, as you have said, because of this change in the tax law. We have immense responsibilities that must be met by our institutions of higher education. Capital facilities, major innovations that are going to have to be made, and additions, for example, in all areas of the university, but science laboratories, and others, is creating a tremendous, tremendous problem in terms—and that relates directly to not only the educational well-being of this country, but the economic well-being as well, in terms of our ability to stay current with research that impacts the productivity of this country. So there are many, many issues here involved. And I appreciate our witnesses taking the time to come.

Dr. Laney, we will begin with you. As I have explained to others—you may have been in the room—we have a huge number of witnesses today. It seems inappropriate to ask a distinguished educator to summarize his remarks so briefly, but we will certainly receive your full statement for the record, and any other data you wish to supply for us. And we would welcome your testimony at this time.

[The prepared statement of Dr. Laney appears in the appendix.]

STATEMENT OF JAMES T. LANEY, PH.D., PRESIDENT, EMORY UNIVERSITY, ATLANTA, GA

Dr. LANEY. Thank you very much, Mr. Chairman. I am deeply grateful for this opportunity to testify on behalf of, and in support of S. 150. And I want to express not only my appreciation, but that of all private, independent colleges and universities for this legislation introduced by Senator Moynihan and co-sponsored by you, Senator Boren.

This legislation, in my mind, would rectify aspects of our tax laws which should never have been enacted; that are very important to private colleges and universities.

And I speak today on behalf of the National Association of Independent Colleges and Universities, an association of almost 850 independent, non-profit institutions of higher education ranging all the way from small liberal arts colleges, to major research universities.

We are deeply concerned about our ability to utilize tax-exempt financing to carry out our educational mission on behalf of this Nation.

Over the years, tax-exempt bonds have been used by colleges and universities, both public and private, for construction and renovation of facilities, whether they are libraries, laboratories, dormitories, major equipment for research, et cetera.

At Emory, we use tax-exempt financing prior to 1986 to finance $250 million of facilities—research facilities where Federal research is being conducted; dormitories, hospital facilities, classrooms, et cetera.

Because of the 1986 $150 million cap imposed on private, independent colleges and universities, we have had to resort to taxable borrowing since then, obviously increasing the costs to families, the overhead to Government, and to the university's own operation.

An important, maybe basic, reason for tax-exempt status for independent, private colleges and universities is that they serve purposes and carry burdens governments would otherwise bear.

In 1986, the Act removed the critical ability of 501(c)(3) organizations to issue tax-exempt bonds above an arbitrary ceiling. And this has fallen especially hard on large research universities with medical centers. Twenty-four at the present time have already reached or surpassed that cap.

Now, how did this happen? Well, first of all, it began by treating the private institutions the same as profit-making ventures; a category that we strongly object to. In short, it removed the distinction between private and non-profit institutions, like universities and private for-profit organizations or ventures. That is the first thing that must be corrected.

The Act also has the effect of discriminating. Tax-supported colleges and universities still have access to tax-exempt borrowing through their States, without limit. But these 24 research universities that I mentioned, all private, are precluded from issuing new tax-exempt bonds. And those represent 20 percent of the independent doctoral granting institutions, like Emory.

I therefore, Mr. Chairman, urge repeal of the $150 million limit, because one, all of our institutions—and I would include, Mr.

Chairman, your trusteeship at Yale—need very much to renovate old facilities.

The National Science Foundation reports that for every dollar that we are spending now for renovation and repair, $3.60 remains untouched. Most capital expenditures these days goes for renovation and repair to bring them up to code and up to state-of-art.

Second, the $150 million ceiling unfairly singles out independent colleges and universities. We do not want them—us—to have any special advantage; we simply want to have parity. We would like to be unshackled from what we feel is an arbitrary, inappropriate limitation of our ability to offer tax-free bonding that would continue to make us the envy of the world with our research and our education.

Thank you very much for supporting S. 150. We support it with you, and I appreciate you allowing me to appear and give this testimony today.

Senator BOREN. Dr. Laney, thank you very much. Do you have any figure on the total amount of unmet capital needs, or even the figure on the total amount of unmet scientific research facility needs in the university community across the country?

Dr. LANEY. I do not. It would be on horseback, yes. I know that, for example, I am also familiar with the institution you spoke of, in that the President of that institution has said that he has a billion dollars in deferred maintenance costs.

Senator BOREN. Yes.

Dr. LANEY. And we begin there. I am not talking about new facilities. And proportionately, all of us have comparable problems that we must face.

Senator BOREN. So we are really into the billions and hundreds of billions of dollars probably deferred——

Dr. LANEY. Well, we are certainly in the billions of dollars. I would not say hundreds, but it is absolutely essential to allow us to move with some facility. This is simply a hobbling of our capacity to be competitive world-wide, as well as do the service to the country here in the Nation.

Senator BOREN. And we are particularly impacting those universities that have been the leaders in the research effort.

Dr. LANEY. Right.

Senator MOYNIHAN. Mr. Chairman, if I could just make a professor's observation, I think what we are also experiencing—I feel very seriously about this—what Schumpeter called the "conquest of the private sector by the public sector." He said that this conquest would be an inexorable proceeding of the 20th Century, and a much more powerful force than anything that the Marxists ever dreamed of.

And you see it right in front of you. I mean, where did the proposal to put the private universities out of business come from? From the administration which nominally most espoused the private sector.

And so, when the Reaganites knocked down the Emorys and the Yales, you know you have got a social process on your hands. You had better understand it, or it is going to defeat you.

We are so grateful to you, sir.

Dr. LANEY. Let me just say, Senator, that speaking of the points of light, I would ask the President to let our light shine.

Senator BOREN. Thank you very much.

Senator MOYNIHAN. Mr. Chairman, I have to tell you you have a vote that——

Senator BOREN. We have a vote. We are down to the last panelist. Dr. Katz, I hate to ask you to——

Senator MOYNIHAN. I can go over and have it held for you, if you would like.

Senator BOREN. You want to go over and start?

Senator MOYNIHAN. Yes. I——

Senator BOREN. And then we will probably just have to take a short——

Senator MOYNIHAN. I will tell them you are coming.

Senator BOREN. We are coming. And why don't we try to get Mr. Katz's testimony in before we break; that way we will not hold you.

STATEMENT OF LOUIS H. KATZ, VICE PRESIDENT AND TREASURER, GEORGE WASHINGTON UNIVERSITY, WASHINGTON, DC

Mr. KATZ. Thank you. I will be very brief. Thank you, Mr. Chairman and members of the subcommittee. My name is Louis Katz. I am the vice president and treasurer of the George Washington University here in Washington.

I am also here on behalf of the same associations that President Laney mentioned, The National Association of Independent Colleges and Universities, American Council on Education, American Association of Universities, and National Association of State Universities, and land grant colleges. Thank you for the opportunity to appear before you today.

I am testifying in support of legislation introduced by Senator Moynihan which would make two important changes in the Tax Code which are critical to the health and continued viability of colleges and universities across the nation.

This legislation, S. 150, would first modify the characterization under the current law of bonds issued by independent colleges and universities as private activity bonds.

And second, the legislation would remove the $150 million limit on the amount of non-hospital tax-exempt bonds that a non-profit organization could have outstanding at any time. President Laney has already appropriately discussed the disparity between the independent higher education, the institutions, and our public counterparts. I do have a few remarks before I address the impact of the $150 million limit.

The 1986 decision to re-characterize tax-exempt bonds issued by independent colleges and universities as private activity bonds, has significant tax policy implications, and is deeply troubling.

It imposes different rules on independent colleges and universities than their public counterparts, despite the fact that both public and independent institutions have identical public purpose missions.

The $150 million limit reflects a congressional objective that was addressed and achieved by other tax rules contained in the 1986 Act.

The 1986 Act included a number of modifications to tax-exempt bond rules for 501(c)(3) organizations, including arbitrage rebate requirements, as well as bond maturity, hedge bond, and advance refunding restrictions. These changes, as well as the TEFRA public approval requirements, rend the $150 million limit obsolete.

This special limit has also impacted smaller institutions that have participated in pooled financings. These schools traditionally do not require large amounts of capital, and thus, do not find it cost-effective to issue tax-exempt bonds on their own.

However, by participating in a pooled financing, they are able to share and gain the access to the capital markets without the presence of these larger institutions which have been restricted by this cap in the tax-exempt market. These pooled financings simply are not available for many smaller colleges and universities.

In conclusion, I would like to state that many feel that the $150 million cap was a wealth test. I would like to say that at the university that I am at, George Washington University, it is not a wealth test.

Our endowment provides the university approximately 3 percent of our revenues. I think most public institutions would find it very difficult to operate if their public appropriations were cut to that level.

I would also like to state that 3 percent that we receive from the endowment barely makes up half of the amount that we, on an institutional level, provide for financial aid.

Mr. Chairman and members of the subcommittee, I urge you to give favorable consideration to Senator Moynihan's legislation. Thank you.

[The prepared statement of Mr. Katz appears in the appendix.]

Senator BOREN. Thank you very much. You make an excellent point: that it is not only those universities that are considered wealthy, if we can use that term, that have huge endowments, that are impacted here. Instead, there are institutions of all sizes and all circumstances that are certainly struggling. Let us put it this way. It affects all universities that have needs——

Mr. KATZ. Absolutely.

Senator BOREN [continuing]. That they are trying to meet. In many cases, when they do not have the funds themselves, they are the most impacted because they must resort to borrowing up-front to finance these facilities that are vitally needed, or to finance renovations.

So, you make a very, very good point and present very strong testimony. And I know this will help our case when we argue it to the full committee in terms of trying to get this changed.

We are going to have to take a very short recess because of the vote. When we return, we are going to have to change the order slightly. Senator Bradley will preside over the next part of the hearing, which will be a panel consisting of Mr. Robert Hill, Mr. Daniel Mica, and Mr. Denis Mullane, in regard to the Living Benefits Bill, S. 284. Then we will go the panel on S. 649, the boat tax question, with Mr. Napier and other colleagues; followed then by the panel on the pension and retirement income, S. 267, including Mr. Duncan and colleagues.

So, that will be the order when we return. Senator Bradley will preside over the next portion of the hearing, and we will begin with Mr. Hill and his colleagues on that subject. We will have a brief recess.

[Whereupon, the hearing was recessed at 12:06 p.m.]

AFTER RECESS

Senator BRADLEY. The subcommittee will come to order. We will now hear a panel consisting of Robert Hill, executive vice president and chief actuary of Prudential Insurance Co.; Dan Mica, executive vice president of Federal affairs, American Council of Life Insurance; and Denis Mullane, chief executive officer and president of Connecticut Mutual.

Gentlemen, welcome to the subcommittee. Let us begin with Mr. Mullane, and then Mr. Mica, and then Mr. Hill. The floor is yours. Mr. Mullane, you want to begin? You may be the first witness.

STATEMENT OF DENIS F. MULLANE, CHIEF EXECUTIVE OFFICER AND PRESIDENT, CONNECTICUT MUTUAL LIFE INSURANCE CO., HARTFORD, CT

Mr. MULLANE. I was under the impression, sir, that I was to be the third.

Senator BRADLEY. No, you will be the first witness.

Mr. MULLANE. All right, sir. Thank you very much for the opportunity to address the panel. I am Denis Mullane, the CEO of Connecticut Mutual, the sixth oldest life insurance company in the United States, celebrating today its 145th anniversary.

I would like to add my support for the Living Benefits Bill, Senate 284, and to thank both you, sir, and your very talented staff, and Senator Lieberman and Representative Kennelly for your leadership on this bill.

Since my written testimony is already on file, I shall not read it to you, but I would like to make a couple of points.

Senator BRADLEY. Your full statement will be in the record, as will all the witnesses' testimony.

[The prepared statement of Mr. Mullane appears in the appendix.]

Mr. MULLANE. Thank you, sir. One of the reasons that we consider it important that this bill be passed promptly is that while we are currently making this benefit available to new policyholders, the clarification of the tax status of these payments would make it possible for us to make these benefits payable to our own policyholders, as well.

Connecticut Mutual has a 1.4 million insureds who would benefit from this, and it has been longstanding tradition of our company to offer new benefits to our existing policyholders at no additional cost. As an example, in my own case, I have a policy purchased in 1956, which has been liberalized 19 times at no additional cost.

The cloud over the tax status, both over the company and the insureds, is preventing us from making a responsible decision to do that at this time.

In addition to that, I think it is important to make the point that this bill is very definitely a pro-family bill in the sense that with

the unrestricted use of the proceeds, it allows a family to sit together and determine what is the best use of this money rather than having it channeled in any specific way.

Decisions can be made about whether it is needed mostly for health care or needed for education, or for other things that will keep the family together. Having it available during this last year may also prevent the family from having to borrow, which would obviously add to the cost of keeping the family together.

So, we think it is a very important bill, and should be acted on as promptly as possible.

Senator BRADLEY. Thank you very much, Mr. Mullane.

Mr. Mica.

STATEMENT OF DANIEL MICA, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN COUNCIL OF LIFE INSURANCE, WASHINGTON, DC

Mr. MICA. Thank you, Mr. Chairman. It is a pleasure to be here. Let me first say I am accompanied by Steve Kraus, who is our Chief Counsel for Pensions at the American Council of Life Insurance.

I am testifying on behalf of the insurance industry, the American Council of Life Insurance. We represent some 616 companies with about 94 percent of all life insurance in force in the United States.

I am also testifying on behalf of the Health Insurance Association of America, which represents 300 private health insurance companies providing health insurance for some 95 million Americans.

We are pleased to express our support, Senator, for your bill, S. 284. As you know, it would treat accelerated death benefits on account of terminal illness as a non-taxable death benefit.

As a result of recent activities by some of the nation's largest insurers who are offering terminal illness accelerated death benefits to existing policyholders, more than 4 million individuals are now eligible for this benefit.

Therefore, we think it is vitally important that Congress act quickly on this issue. We do believe that your bill is an excellent first step, and like many who are in the room today we would like to see Congress do additional work in this area.

First, Congress needs to clarify the tax treatment of death benefits which may be accelerated under conditions other than terminal illness.

Second, we think Congress should clarify that long-term care insurance be treated like health insurance. Taken together, this three-pronged approach will help address an important aspect of the health care crisis facing this Nation.

We are all concerned, obviously, about the escalating costs associated with terminal illness, catastrophic illness, and the need for long-term care. We believe there is an important role for the private sector, indeed, the public/private sector has been a winning combination for many years for this country. And we would like to see it continue, particularly in providing protection against the

devastating financial impact that these costs have on individuals and their families.

The life and health insurance industry has developed some innovative products that could be helpful to meet these needs. Unfortunately, the reason we are here today, the ambiguity of the tax treatment of these products is discouraging the public from purchasing these items. The tax law needs to be clarified as quickly as possible to foster growth and development of these products.

Senator, let me stop my written testimony here, even my summary, just to point out something I noticed during my nearly 20 years in public service. Rarely does an insurance product get editorial praise throughout the Nation.

In fact, in talking with folks who have made a career with this industry, they say it is almost unheard of. But I have with me editorial comments from the New York Times, the Denver Post, U.S.A. Today, Atlanta Journal, Fort Worth Star Telegram, Detroit Free Press, and some others, essentially saying the concept of accelerated death benefits is excellent, and Congress needs to act quickly.

I see that the time is running out here, so I will just point out that in addition to terminal illness which is covered in your bill, we do have concerns over the tax treatment of accelerated death benefits for long-term care, catastrophic illness, and permanent confinement to nursing homes.

I believe I will stop here and submit my statement for the record. We have some statistics on the number of companies—over 70 that started out, over 100 that are now involved in selling accelerated death benefit products; some Roper Organization polls showing very, very strong national support for the concept that you have embodied; and ask you to move as quickly as possible, and hopefully bring into the legislation as much as possible that could be handled in this session of Congress.

[The prepared statement of Mr. Mica appears in the appendix.]

Senator BRADLEY. Thank you very much, Mr. Mica.

Mr. Hill.

STATEMENT OF ROBERT P. HILL, EXECUTIVE VICE PRESIDENT AND CHIEF ACTUARY, THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, WASHINGTON, DC

Mr. HILL. Thank you, and good morning. I am Bob Hill, executive vice president of the Prudential Insurance Company of America. I am pleased to have the opportunity to testify today in support of Senate Bill 284.

Before I get into the subject, I would like to take this opportunity to thank you, Senator Bradley, and thank Senator Lieberman for your leadership and his leadership on this issue, as well as Senator Lautenberg, and the other co-sponsors of this bill.

Medical science has made enormous strides in keeping people alive, but there does come a time when no more can be done to prevent the inevitable. Then, the best thing that can be offered may be a way to help provide peace of mind; the ability to live out life in dignity, and that is what this bill is all about.

It will insure that the life insurance benefits that terminally ill patients receive while they are alive are not taxed, and that is simply the same treatment as if the benefits were paid a few months later after death.

To illustrate the importance of this bill, I would like to tell you about our first accelerated death benefit payment. Our president, Ron Barburo, was visiting with some AIDS patients. He talked with one who was virtually destitute, but he did have a Prudential policy. And Ron thought to himself, how much better this patient's life could be if he could unlock the value of the death benefit in his insurance policy. So Ron asked, "Why not pay the benefit now?" So we made a discounted payment in advance, and helped make our insured's final months more comfortable.

We now have what we call our living needs benefit program. This allows policyholders to receive death benefits before the insured dies when there is certification of a terminal illness by a physician

The use of the funds is unrestricted, in the same way as benefits paid after death on the normal life insurance payment. Our experience is that the funds have been very well used. Typically, they have been used to pay for extra medical or home care, to pay off a mortgage, to set up plans for the financial security of dependents, or to fly loved ones in for a final visit.

We began our program about 16 months ago. So far, more than 135 policyholders have received accelerated death benefits. Most have been victims of cancer or AIDS. Though their number is relatively small, the difference these benefits have made in their lives is great.

Today, more than 900,000 Prudential policyholders have a "Living Needs" rider on their live insurance policies. The Prudential makes it available on both existing and new permanent life insurance policies at no extra charge. We do not make money on this program, it is just the right thing to do, which brings us to your bill.

First of all, it would explicitly exclude from taxable income accelerated death benefits for the terminally ill, and this only makes sense. Section 101 of the Tax Code already excludes from taxable income benefits paid by reason of death. And accelerated death benefits are death benefits, they are just paid a few months early.

We do not believe that terminally ill people have to pay taxes as the price for receiving their death benefits a little early. This legislation would make it absolutely clear. We believe the legislation would have no adverse revenue impact, because under current law, death benefits are already paid on a tax-free basis on the death of the insured.

Indeed, to the extent a terminally ill person used accelerated death benefits to pay for medical costs that would otherwise be covered by Federal programs, the Federal Government may realize a net savings.

Besides income tax treatment, S. 284 would clarify something else. Policyholders would not be required under the eligibility test for SSI and Medicaid to make a claim for their accelerated death benefits. This makes good sense, too.

There are compelling arguments that current law already covers these two issues, but S. 284 would make it crystal clear. Let us give the terminally ill help with their financial worries. S. 284 can enable them to live out their last days in dignity. We at the Prudential urge you to pass it. Thank you very much.

[The prepared statement of Mr. Hill appears in the appendix.]

Senator BRADLEY. Thank you very much, Mr. Hill, Mr. Mica and Mr. Mullane. I appreciate your testimony. I would like to ask just a few questions. You heard Mr. Gideon today raising his series of problems. And one of them relates to whether the fund should be restricted to certain things; certain uses. Is it your experience that these funds have been well-used by recipients to date, Mr. Hill?

Mr. HILL. That certainly is our experience, Senator. The stories really are very heart-warming. Our claims people have talked, of course, with the claimants and the beneficiaries. In fact, media reports have been considerable on TV, and on the radio, and in the paper. The experience really is that very often the money is used to cover mortgage payments, to cover homemaker expenses, to cover medical expenses that are not covered by the medical plan. Often these people are very short of resources. They are out of their job, and they are short of cash. We have saved many houses for people that were going into foreclosure. So, our experience is, indeed, that the funds have been very well-used.

Mr. MULLANE. I think it is appropriate——

Senator BRADLEY. Mr. Mullane, do you have a few stories that you can tell about the use of funds?

Mr. MULLANE. I think it is entirely appropriate, sir, that the families themselves should decide what is the best use of their money for their unique circumstance. Limiting the use of these funds might prevent—for example, using the money to provide for re-training or education of a spouse so that that spouse could earn enough money to keep the family together after the death.

Senator BRADLEY. Yes. I think those are very good points. Flying in a relative, I think you said in your testimony, in the last weeks of an illness. What about the concern about fraudulent terminal illness? And I assume those who oppose it on this ground raise the specter that maybe doctors will, what, not be honest? I mean, make a mistake? I mean, do you see this as a problem?

Mr. HILL. Well, we, of course, are in the business of paying claims and operating a sound financial institution. So, we are very experienced in working with doctors on claims of all sorts, so you cannot say that you will never have a fraudulent claim, but certainly, our financial interests are very strong to make sure that the claims are valid, and we certainly will do that. I do not think the Treasury needs to worry about that; we will do it.

Senator BRADLEY. Mr. Mica.

Mr. MICA. Well, I just second what was said here. Not only will the companies be very, very careful because they will be the ones paying out the money, but from a public policy perspective, certainly every governmental program has a potential for abuse, and I cannot imagine anybody objecting to a strong system to check on fraud and to make sure it does not happen. We see that, obviously, from Medicare to Medicaid, and we will prohibit it. There will be

laws against it, and I guess there will be people who will try to do it.

Senator BRADLEY. Mr. Hill, another objection that is raised that somehow or another this is going to be a selling and marketing technique. I mean, as I heard your testimony, Prudential does not make any money on these, that this is truly an effort to reach out and help people in real need and distress. Do you want to comment on people who see danger where there are no dangers?

Mr. HILL. Well, yes. As I described our program, we did start by looking at our in force customers. In fact, we had people we saw were in need, and we wanted to help them. We designed our whole program so that it would apply to our existing base. Much as my colleague here described, when we liberalize our plans of insurance, we want to apply those liberalizations to everyone. And that is why we designed a program that had no additional costs.

So, the fact that the product is, as a result of this change, more useful, more flexible, more valuable, I do not feel we should defend that. I think that is good, and it is good for the American public.

Mr. MULLANE. I would like to add to that, sir, if I may. During the year that we have been doing this, we have not seen any sudden upsurge in sales that would validate that somehow this makes the product that much more attractive. And the other thing I would say is I can hardly see how the existence of this provision would make it any more attractive to be terminally ill.

Senator BRADLEY. A very good point. Very good point. Senator Chafee.

Senator CHAFEE. As I understand it, if you did this, there would be no income tax consequences. If this did not occur, there would be estate tax consequences, correct?

Mr. HILL. Correct.

Senator CHAFEE. In other words, the insurance would count in the estate of the individual if the individual did not receive it in this form. So, it does cost the Federal Government some money, if you want to look at it harshly, is that not right?

Mr. HILL. I do not think there is any estate tax effective at this date.

Senator CHAFEE. The estate. I am talking estate.

Mr. HILL. Yes, I know.

Mr. MULLANE. Yes, sir. There is an estate tax on the death benefit in the event the insurance policy is owned by the insured. As a result of that, very few insurance policies are, in fact, owned by the insured. And in that event, there is no estate tax.

Mr. KRAUS. Senator, there is also a 600,000——

Senator BRADLEY. Would you state your name, for the record?

Mr. KRAUS. I am Steve Kraus with the ACLI. There is also a $600,000 estate tax exemption, and so, in order for there to be any estate tax in the first place, there would have to be assets in the estate of at least $600,000.

Senator CHAFEE. Is there any suggestion that to have this work, that the amount, even though it had been paid and expended, would count toward the estate of the individual, if, indeed, it would have normally been included in the estate. Do you see what I am saying?

Mr. KRAUS. Could you repeat the question, please?

Senator CHAFEE. Well, let us say that the individual did own the policy and it comes to the individual in the terminal illness and is expended. Let us say that $100,000 is paid out to the insured and that when he dies there is $10,000 left. What would be the reaction if you still counted it in the individual estate as it normally would have been? Now, maybe there is no money to pay it, it is all gone. Well, never mind. I will not put you in a position of answering that question.

Mr. KRAUS. I think the answer would be that, you are right, if the money was expended on account of the terminal illness, there is nothing left to tax in the estate.

Senator CHAFEE. Yes, except—well, never mind. Let us go on.

Senator BRADLEY. You mean, if the individual takes the benefits and invests it in a growth stock, and in 6 months is worth $32 million——

Senator CHAFEE. No.

Senator BRADLEY [continuing]. That $32 million is part of the estate of the individual who just died. So, I mean, we catch him in an estate tax net regardless. It is just a matter of whether they get the benefit before they die without an income tax.

Senator CHAFEE. Well, I will not pursue this any further. Thank you. Thank you, Mr. Chairman.

Senator BRADLEY. Senator Breaux.

Senator BREAUX. No questions. Just thank the Chairman for bringing this to our attention. I am a co-sponsor of his legislation, and it is good to see our good friend and former colleague, Congressman Mica, before the panel. Thank you.

Senator BRADLEY. Mr. Mica, could I ask you, how many more insurance companies do you think would offer this kind of product if this were enacted?

Mr. MICA. I think we cannot project, but we have been talking to our member companies. I think a large number of companies would take advantage of this, and maybe a little bit in the vein of Senator Chafee's comments that there certainly will be some impact on the calculations that would be done by Joint Tax.

But we first start with the premise that if they died and received the money, there would not normally be a tax, so this money should be given before death without a tax under certain circumstances. And in addition——

Senator BRADLEY. You had a number in your testimony for the number of companies that——

Mr. MICA. Yes, sir, we do. We started out with 70 companies that were offering it, and it went up to, I believe, over 100. As I indicated, we represent 616 companies, and we think there would be a tremendous interest in it. The point that I was going to make, though, with regard to cost, is one of the things that Joint Tax does not calculate, and I have seen this many times over the years in things that I was involved with. They had a program where we vaccinated for polio. They figured it would cost so many million dollars a year, and it was an expenditure to the government.

Joint Tax is not allowed, nor do they calculate, that by vaccinating for polio, the government is saved hundreds of millions of dollars a year, and what I am saying is there will be some public offset of any cost for people who do not become a public charge be-

cause of taking care of their own needs. And that figure is never calculated when it is given to the Congress.

Senator BRADLEY. Yes. What do you have to say about the slippery slope argument that the Treasury Department offers? If you do this today for the terminally ill, tomorrow you will be in here for housing accounts, boat accounts, whatever. I say that to draw the whole room's attention to this bill. [Laughter.]

Senator BRADLEY. Mr. Hill?

Mr. HILL. Well, it seems to me the event of death is very clearly defined, and I do not see that there is any difficultly in distinguishing a terminal illness from education. I do not see the slippery slope argument applying at all.

Mr. MULLANE. Well, I think also, sir, that the event of death is actuarially calculable in advance, whereas the other kinds of things you have mentioned are not. And I think the Congress can count on the fact that we need to protect the financial stability of our companies, and would not be willing to enter into the kind of arrangements that would present the kind of risk that you have just described.

Senator BRADLEY. Yes. I think that is a good point. Mr. Mica, you had your three-prong approach. If we cannot do anything about long-term or catastrophic, you still think it is wise to move ahead with this very limited, but very humane bill, do you not?

Mr. MICA. Senator, we are absolutely not here to muddy up the waters. We like your concept, your bill. We would love to see it enacted. Obviously, I represent several hundred companies who would like to have some additional pieces to that puzzle, but we understand the political reality.

And in answer to your previous question, the reality is that health care is a crisis in this Nation, something needs to be done now, and whatever can be done now ought to be done now. So, we would like to see the full three prongs, but we obviously support your concept, your approach. And if that is all we can do right now, we will do it.

Mr. MULLANE. I would agree, sir, that there are terminally ill families that are depending upon the passage of this bill right now, and to confuse that matter with other matters would be a shame.

Senator BRADLEY. Let me thank all three of you very much for your testimony. I think that you have taken the concerns head on and I appreciate your candor and knowledge, and I look forward to working with you in the future. Thank you very much.

We now have a panel consisting of Jeff Napier, president of the National Marine Manufacturers Association, Chicago; Mr. Shep McKenney, Hinckley Co., Southwest Harbor, ME; Everett Pearson, president, Tillotson-Pearson, Warren, RI; Mr. John Chantrey, president, Schubert's Marine Sales Services, New Orleans, LA; and Dr. Dennis Zimmerman, specialist in public finance, CRS. And welcome to the subcommittee, and the baton of the chairmanship will now be passed to Senator Breaux.

Senator CHAFEE. Mr. Chairman, while this panel is getting seated, I wish to state on behalf of the distinguished Majority Leader, Senator Mitchell, that he, unfortunately, because of his leadership duties, cannot be here. He wanted to extend again a

welcome, as he personally gave it earlier to Mr. McKenney, chairman of the Hinckley Co. of Southwest Harbor.

And Senator Mitchell wanted me to stress to everyone his deep interest in this subject, his concern over this luxury tax. I have trouble getting the words out, I find them so distasteful. And as you know, Senator Mitchell gave a statement earlier in the day. So, he is sorry he cannot be here.

Senator BRADLEY. Thank you. Senator Chafee, I appreciate it. I know that this industry is in deep stress, and that is what this hearing is all about. It is an attempt to get all the facts out on the table so we can respond to what is a legitimate crisis in this industry. Senator Breaux.

Senator BREAUX. Let me welcome the panel, but start by asking our colleague who has been here waiting and has to go back to the floor, what we have done with all other Senators who have been here, is to allow him to give us his remarks on a matter that is scheduled for the next panel. And if our panel members will just bear with us for a moment, we would like to welcome our colleague, Harry Reid, from Nevada.

Senator Reid is fresh from a victory. I know who lost, and I also know who won. Senator Reid just had a big victory on the floor on his amendment. So he should feel flushed with excitement and pleasure.

Senator CHAFEE. I think that the Senator from Rhode Island shows great character in not objecting to Senator Reid testify right now out of order.

Senator Reid.

STATEMENT OF HON. HARRY REID, A U.S. SENATOR FROM NEVADA

Senator REID. Thank you very much, Mr. Chairman. Also, you, Senator Chafee, a man who, as I have told you personally, I greatly admire not only what you have done in the Senate, but what you have done outside the Senate as well.

I would like to take about 5 minutes and talk about something that is extremely important to the people of this country. First, I thank the committee for allowing me to testify, and also, I thank Mr. Bill Hoffman from the State of Nevada, who is here today to acknowledge the magnitude of the source tax issue.

A few years ago, I was approached by a Nevadan by the name of Bill Hoffman, whom you will hear from later today, who told me about a problem Nevadans were having. You see, many Americans are coming to Nevada to retire because, among many other reasons, there is no State income tax in the State of Nevada.

Bill Hoffman informed me, however, that these new Nevadans were being harassed by their former States of residence and that they were being taxed by them. I have to tell you, Mr. Chairman, I frankly did not believe what he was telling me. I have always been a resident of Nevada, and I have never had another State levy a tax on my income or assets. But I know many, many people have moved to Nevada and other places, retirees and otherwise, who certainly never expected to be told they must continue to pay State

income taxes to the State where they used to live. To be perfectly honest, I stress again, I could not believe what he was telling me.

There are Nevadans and citizens of every State who are forced to pay taxes to States where they do not reside. These retirees pay taxes on pensions drawn in the States where they spent their working years, despite the fact that they are not present to participate in the programs which their taxes are funding.

They do not participate in Medical Assistance programs, visit senior centers or public parks, or even vote in their former States of residence. Yet, they are still being asked to pay taxes—not only on the pension income, so-to-speak, but on all their income.

No one wants to pay a penny more in taxes than he or she has to; we all know that. But most Americans graciously pay what they owe. They pay because they know what they are getting in return, and, in the United States, we get a lot in return.

But you do not get a single benefit from a State in which you do not reside, except in some instances. And that is what we are here to talk about today: a tax bill. As you will hear many times today, this is taxation without representation. This practice is affecting more and more Americans as economic times become tougher, and certain States have become more creative in looking for revenues. That is why Retirees to Eliminate State Income Source Tax, RESIST it is called, founded in July of 1988, has grown beyond the borders of Nevada, to include members in every State of the Union.

This is a non-profit, grass-roots organization in the truest sense of the word. It operates entirely through the work of volunteers; no members are salaried. The credibility of this group has convinced other long-established organizations, such as the National Association of Retired Federal Employees, to make a commitment to prohibiting taxation of non-resident retirement income.

This is a bipartisan effort of millions of Americans who cannot live with unfair reductions in the fixed incomes which their retirement provides them. I know of people who are taxed at a rate which reflects their entire income, not just their income derived from the taxing State.

An individual could find himself or herself paying a tax on his pension that far exceeds the rate that would have been applicable at the time the pension was earned. He could also find himself paying tax on the same income to more than one State. Most States offer a tax credit when their residents pay their income taxes to other States. While this allowance is admirable, the State offering the credit is losing revenues. If I retire from California to Oklahoma, and California decides to levy on a tax on my pension, Oklahoma will most likely grant me a credit for the amount I owe California.

But Oklahoma will still be the State providing me with the Medical Assistance and other senior programs, as well as access to its parks, not to mention the right to vote. And Oklahoma will be providing me all this free of charge, since California will be receiving my tax dollars.

To prohibit this, I believe, unethical practice, I have offered legislation which prohibits States from taxing pensions on retirement income of non-residents. States are crossing State lines, collecting taxes from non-residents, and are retreating and offering nothing

in return. State residents who conscientiously pay taxes on their pensions have the privilege of voting in this State. Non-residents just pay.

All too frequently, retirees are unaware that they must pay tax to the State from which they draw their monthly pension check. As in Nevada, many people plan retirement in States with low or non-existent income tax, and spend and save accordingly. Notifications of back tax and penalties to a State other than where someone resides is rightfully met with indignation and horror. The indignation rises from the shock of post-Revolutionary taxation without representation. The horror rises from the inability to pay an enormous tax debt when one lives on a fixed income.

Once more I would like to thank this committee for allowing me to testify and to remind the committee that there are numerous organizations that support this legislation.

Senator BREAUX. Harry, let me just ask you one quick question. I think you have raised a very interesting point. The situation you have described and the situation like we have in Senator Bradley's area a person who works in New York City but retires, say, in New Jersey, spends his time there, lives there, has his house there, but still must pay his income tax on pension payments in New York on money that he earned working in New York during the day, even though he retires and resides, say, in New Jersey, must also pay taxes in New Jersey.

Senator REID. I think that there are some legal arguments that show a difference. I think they are a difference of degree, rather than a different in kind. I would submit that a person working there receives some benefits from the State; they have the subway system at their disposal, they can walk at noon time to a park. There are a lot of things the State of New York has to offer someone who is working there. We are talking about someone that is not even in the State, does not live there, and most of the time does not want to return.

Senator BREAUX. Good point. Questions?

Senator BRADLEY. Well, let me thank Senator Reid for his testimony. I think it is a very important issue. I, of course, would like to broaden it, but I think it does address a very specific problem and it is one that is felt in a lot of places outside of Nevada. New Jersey is one of them.

Senator REID. That is right.

Senator BRADLEY. Thank you.

Senator REID. I would also want this committee to know that it does not cost the Federal Government a single penny.

Senator BREAUX. Thank you, Senator, very much, for your presentation.

[The prepared statement of Senator Reid appears in the appendix.]

We would like to take the panel in reverse order from how it was set out in the witness list, and we will take from the Library of Congress and the Congressional Research Service, Dr. Dennis Zimmerman. Dr. Zimmerman, if you would go first, we would be pleased to receive your testimony.

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STATEMENT OF DR. DENNIS ZIMMERMAN, SPECIALIST IN PUBLIC FINANCE, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS, WASHINGTON, DC

Dr. ZIMMERMAN. Thank you, Mr. Chairman and members of the committee. In 1990, 504,100 boats were sold, of which 9,100—1.8 percent—were in the two categories identified by the National Manufacturers Marine Association as containing boats subject to the luxury tax. Total sales were $4.6 billion, of which 33.8 percent were in the luxury boat class. These 1.8 and 33.8 percent figures represent upper bounds on the share of the boat industry subject to the luxury tax.

The model detailed in my written remarks estimates the influence of price and income changes, both individual and business, on the demand for luxury-class boats. The model accurately tracks sales over the 1970 to 1990 period, including the decreases in sales that occurred during the recessions of 1974 and 1982, and the very large decrease that occurred in 1990.

I conclude from the estimates of the model that luxury boat sales have not been responsive to real price changes over this 1970-1990 period. If this zero relationship exists today, the luxury tax probably is not responsible for the sales reductions being experienced currently by the boat industry. The model also estimates that sales are quite sensitive to changes in real disposable personal income, and somewhat sensitive to changes in real after-tax corporate profits.

The finding of a near-zero price sensitivity is, of course, a difficult proposition for the boat industry to accept, particularly at a time of decreasing sales when a new excise tax has been imposed.

Suppose we assume the price elasticity is actually equal to minus one. The average nominal sale price of these 9,100 luxury-class boats sold in 1990 was $171,000, which implies an average tax of $7,000, or 4.2 percent of average price.

Thus, even assuming demand to be price-sensitive, the expected decrease in boat sales due to the luxury tax would be 4.2 percent. Industry revenue would be expected to decline by about 1.4 percent, far short of the large decreases being reported in the press.

Of course, I must re-emphasize that based on data for the last two decades, the model estimated finds no such sensitivity to price.

When ones looks at the sales data for the boat industry, it is quite clear that something very unusual happened in 1990. The number of luxury units sold declined by 37 percent; a decrease far beyond any experienced by the industry since 1970. This drop in business cannot be explained by observed changes in individual or business income, nor can it be explained by the luxury tax, whose pending adoption for 1991 ought to have accelerated 1991 sales into 1990 in order to avoid the tax.

The model treats this 1990 experience as an unexplained downward shift in the demand for boats. Consumers desired to purchase considerably fewer boats, no matter what their price. Several possible explanations come to mind.

First, there is preliminary evidence that the change in real disposable personal income for the portion of the population that buys luxury boats suffered income reductions substantially larger than

other portions of the population. With a 1.8 income elasticity, a large income decrease among the wealthy could explain a significant portion of the drop in sales.

Second, the Gulf War increased uncertainty, and may have made buyers reluctant to purchase boats beginning in the third quarter of 1990.

Third, it is possible, given the rapid increase in sales throughout the 1980's, that the market for luxury boats is saturated. And fourth, the relationship between the markets for new and used boats may have changed substantially in 1990.

Perhaps what we are observing is the combined effect of the four factors. Whatever the cause, it is clear that the luxury boat industry has experienced a substantial decline in business. However, the model discussed here indicates this decline is not attributable to price changes, and certainly not to the luxury tax on boats.

In closing, I would like to make a brief comment on a 1987 Patton Boggs & Blow study on luxury boats. Their study uses the same output and price data that I have used, but estimates a large price sensitivity equal to minus two. I believe their estimate of price sensitivity is incorrect.

Their use of nominal rather than real values causes the income and price variables to be highly correlated. Unfortunately, their technique for handling this statistical difficulty has the effect of pre-determining a high and arguably incorrect estimate of price sensitivity, and rendering the estimate unsuitable as a guide for policy.

Again, thank you for the opportunity to share my results with you.

[The prepared statement of Mr. Zimmerman appears in the appendix.]

Senator BREAUX. Thank you very much. We will have questions for you in a moment. Let me see.

I am delighted to welcome from Louisiana Mr. John Chantrey. John, we appreciate you very much coming up. I have not had a chance to visit with you, but I am looking forward to your testimony.

STATEMENT OF JOHN CHANTREY, PRESIDENT, SCHUBERT'S MARINE SALES AND SERVICES, NEW ORLEANS, LA

Mr. CHANTREY. Thank you, Senator Breaux. On behalf of Schubert's and Schubert's people, we appreciate the tireless efforts you have put forth to attempt to repeal this bill. As you and I both know in Louisiana, we have been in a recession for almost 10 years now. You have done a great job, and we have great respect for your abilities. I greatly appreciate the opportunity to appear before this distinguished committee.

As a small boat businessman, this subject has turned the entire future of our business from a progressive business with new markets, to a business that will shortly be fighting to survive.

From 1981 to 1987, Louisiana's economy was failing to the degree we had never seen before. In 1987, betting that the worst was over, I purchased Schubert's Marine, a run-down boat yard and fuel dock that was and is located in the most perfect location in the Gulf

area, in between two major marinas, and in the middle of West End Park.

Over the past 20 years of boating and yachting activities over an entire lake, I was able to bring large sailboat work to what was a power boat yard exclusively. This increased our sales by 35 percent in our first year of operation and put us in the black. I began the first phase of three modernization phases at the end of 1987—reminding you that we are still in a very bleak economy—by purchasing and installing a 65-ton yacht hoist that replaced a dangerous 20-ton lift. This allowed us to service yachts to 70 feet, as compared to 40 feet previously. We added highly skilled and specialized personnel, and began for the first in Schubert's history, major yacht conversion and customizing. Our sales began to climb.

In 1989, our economy in Louisiana, in the eyes of our customers, were improving. It was improving slowly, but there was a promise that we were out of the rut that we were in for the past 8 years. With sales inquiries building, we ran out of space in our old, antiquated production building, and we sold our first major yacht in the previous 2-year period.

With high expectations of a slow, but improving economy, we built a new production building and parts building with a modern carpenter shop, and outfitting shop, modern mechanics overhaul shop, and a paint and fiberglass shop with offices on the second floor.

During this time, two more major yachts were sold that we outfitted. The sum total of the outfitting of these boats exceeded $400,000. One was a Hatteras, and one was a Viking. Our new facility not only allowed us to be more efficient, but brought us more business from those who wanted to be associated with a first-class yacht yard, and were tired of the problems they were having with small boat yards on the lake.

Then the luxury tax hit us. This tax has stopped qualified buyers in Louisiana from buying yachts. They are turning to condos with second home write-offs, or they are sitting back waiting for the luxury tax to be repealed. We had, in March of this year, a flat cancellation of a qualified buyer buying a 70-foot Hatteras motor yacht.

We sold a year and a half before that his 45-foot Hatteras. He was attempting to put his personal financial portfolio in order to buy the boat before the luxury tax came down. It was impossible for him to do so. He did not do so until after the first of the year, and he has cancelled that order entirely.

What does this mean to the people of Schubert's? This means that with no new yachts being sold, we not only have lost the outfitting and customizing revenues, but in another 3 years, existing yachts in the area will be 7 to t10 years old, making updating and retrofitting, which is the heart of our present business, not practical because of costs. When this happens, the alternate will be our business will fail.

What does this mean to Schubert's people? By October, we will have a 30-percent reduction in force. We are presently in the upswing of the summer season, mainly because of the rains we have had. We have had a delay of 2 months because of that. And secondly, we have a major contract we are working on—two major yachts

in Morgan City. But without the projected revenues and the outfitting of major yachts, that reduction in force will take place.

Second, and if I can make one point clear, we have a short-term and a very short long-term effect on this luxury tax with Schubert's. Initially, we have lost the outfitting revenues—$300,000 to $400,000 a year. That affects our business adversely. But as the fleet ages, the heart of what our business has been all along is going to disappear. And we estimate 2 to 3 years from now there will be a drastic reduction on the amount of retrofits and updating of major yachts just based on age.

What does that mean to the 35 employees of Schubert's, and what does that mean to the owner of Schubert's? I am a person who came up through the corporate rolls. I do not have the fat billfold to carry a financial burden that this tax creates for us over a three or four period of time. And the options are to list the company for sale, perhaps to a major corporation that wants to buy it—it is unlikely because of the personal nature of our business—somebody who has got a much bigger billfold than I, or sell it to developers who want to build condos in West End Park. This is a real situation for me, and I want to make one quick and last remark.

When I put the 65-ton lift in, and it cost over $273,000, I told my key people if they helped me pay for that and the production building that would follow, we could do it over an 8-year period. From that point on, I would share the profits of the company with them, spending less time at Schubert's, and having not to walk the edge financially. Those hard-working people paid for that crane in 2½ years.

Now, I am faced with the fact that I have to face them saying that our projected revenues are going to be such that we will have a tough time, or if we can pay for that facility at all, or I may have to sell the business.

That is real to me. Having come from the corporate world, I have never had an opportunity to work directly with people who help make companies successful. I have in this venture. We have been successful. But we can handle the problems with the economy and the changes in the economy; that is part of being in business. But when we are dealing with a legislative matter that cuts the ability for us to change our direction or to make up in areas that will make us successful in the future, we have no other alternative. I think the final effects of this luxury tax, if not repealed, will have a dramatic effect.

And last, it takes in the area of 10 years to build the specialized people that actually do major yacht retrofitting and modifications. These are not people that can be picked up through ads in the newspaper. Once this art is lost, it will be lost for many years to come.

I appreciate your efforts, Senator. I ask for your consideration. I offer anything I can do to help repeal this law as expeditiously as possible. Thank you very much.

Senator BREAUX. Thank you, Mr. Chantrey. Next, from Rhode Island, Mr. Pearson.

Senator CHAFEE. Well, I join in welcoming Mr. Pearson. I am so glad he is here, and appreciate his coming down. Thank you, Mr. Chairman.

[The prepared statement of Mr. Chantrey appears in the appendix.]

Senator BREAUX. Mr. Pearson.

STATEMENT OF EVERETT PEARSON, PRESIDENT, TILLOTSON-PEARSON, INC., WARREN, RI

Mr. PEARSON. Mr. Chairman, Senators, I am here this morning representing and I am President of ASAP—it is a 150 firms involved in the boating industry—Bristol Sailing Industries, and the Rhode Island Marine Trades Association.

I have been in this business for 34 years, and I have never seen the boat business as such a disastrous state as it is now. We have suffered through the recession, we have had the banking crisis up in New England.

The banking crisis has taken the money away from the boat buyers, floor plan money away from dealers, lines of credit for builders, put a lot of people out of work up there. We have got probably 2,000 people in New England in the boating industry who have been put out of work.

The companies that survived the recession moved up in their product lines, building larger boats. And then last October when the effect of the luxury tax came in, it was a coup de gras for this industry. It shut down the upper end of the whole business, putting a lot more people out of work.

There are three luxury yacht builders in Rhode Island. We have Ted Hood building his line of boats, Alden, and we build the J-44. All these boats sell from roughly $350,000 to $3 million. These companies have been averaging for the last 10 to 12 years roughly over 30 of these luxury yachts a year. Since this tax went into effect last October, Ted Hood has not sold a single boat—zero. The Alden firm has not sold a single boat. In 1989, we sold 19 J-44s. In 1990, we sold 24 J-44s. And since the luxury tax went into place, we have sold two.

It is not the recession that is causing this problem. I have been in the business back through the 70's and I have seen the oil crisis come and go, and I have watched the small boat end of the business fall off, and the luxury end has always held on; it is recession-proof. We had the crisis in the 80's when we had the stock market fall off. Our small boat lines fell right off dramatically. The Alden line and the big boats continued to sell.

Evidence that people are still spending money on boats is the used boat market. The luxury tax has affected the new boats, but they are spending the money on the used boats. And not one job has been created by the people who are buying the used boats. The brokers are reporting the best years ever.

While we are not selling boats in the U.S. market, I would like to point out that last year we started a joint venture with a French firm. And in these last few months, we have sold seven $350,000 Catamarans under a French law, the Loi Pons Law, that went into place in 1986. Any firm investing that creates jobs in the islands, they can write off these boats and create a lot of jobs.

We are asking for a repeal of this. A law that has negative cash flow could be turned into positive cash flow.

I would like to point out that this is not the first time that a government made this type of mistake. In 1973, England had a 10-percent value added tax put on. In 1975, the Labor Party, when they won the election, they proposed cutting the value added tax from 10 to 8 percent, and put on a luxury tax. Within 9 months, they had destroyed over half of the boat building businesses in England, and the tax was repealed at the end of 9 months.

Yachts are an alluring and a logical target to tax; they are the epitome of the public's concept of wealth. But what it is doing here is destroying an industry. I look at it as a boxing match between the government and the wealthy people. And the government has not laid a glove on them, and the only one you are really knocking out is a boat builder. We have got over 19 percent unemployment up in the city of Fall River.

And I ask you now to repeal this tax now and let us put some of these people back to work before you destroy the whole industry. Thank you.

Senator BREAUX. Thank you very much, Mr. Pearson.

[The prepared statement of Mr. Pearson appears in the appendix.]

Senator BREAUX. Next, from Maine, Mr. McKenney.

STATEMENT OF SHEPARD W. McKENNEY, CHAIRMAN, THE HINCKLEY CO., SOUTHWEST HARBOR, ME

Mr. MCKENNEY. My name is Shep McKenney. I am one of the owners of the Hinckley Co., a yacht-building firm in Southwest Harbor, Maine. Thank you for allowing me to testify.

Mr. Gideon from the Treasury Department, earlier said that it was difficult to measure the effect of the luxury tax because it coincided with the recession. I do not think Mr. Gideon has spent much time in Maine, or around boat builders. This thing has been going on for 2 years, and I think most of the firms have done a reasonably good job of dealing with this recession.

At the Hinckley Co. in 1989, we instituted a wage freeze, which has stood. We have eliminated all capital spending. And through 1990, we have been able to maintain reasonably full employment.

But since January 1, sales have gone to zip. We have sold only two boats that are subject to the luxury tax, and what we are finding is that in order to be able to sell boats, we effectively have to agree to absorb the tax. The fact is, people do not want to pay this tax, and it does not take a high-priced lawyer or accountant to figure out the loophole in this tax law. You just do not buy the boat, and people are not.

We have already had to institute drastic steps. We have laid off 10 percent of our work force. We have cut pay for all our remaining employees by 10 percent. I would like to give you some examples of the effect of these cuts.

Bill Garver worked for the Hinckley Co. for 26 years before he became one of 15 people laid off earlier this year. Bill works as a rigger, and his skills are not transferable to other industries. Bill is on unemployment, as are many of the people we have laid off.

Mike LaPlante was an apprentice carpenter, and he was not laid off. But, like our other employees, he had his pay cut by 10 per-

cent. Mike was already struggling to pay his rent, but with a 10-percent pay cut, he could no longer afford to support himself, his three young children and his wife, and he has now moved to Connecticut, where he and his family live with his mother-in-law.

Mike is one of seven employees that have left the Hinckley Co. as a result of the pay cut, including Kay Stein, who could no longer afford day care for her 5-year old daughter Haley, and her 3-year-old son, Evan.

These stories are being repeated across Maine as boat building employment plunges to 50 percent of what it was, and getting worse. I believe that on the Maine coast we build some of the most beautiful yachts in the world, employing the highest levels of craftsmanship. I hope the owners of our boats will forgive me when I say that I believe we own these yachts as much as they do. These yachts are great redistributors of wealth, because of the enormous amount of labor they require.

Today at the Hinckley Co., our principal competitors are foreign—in Taiwan, where the effective labor rate is less than half of ours, and in Finland, where boat building companies are directly subsidized by the government.

We are confident of our ability to compete, despite these adverse circumstances. For that matter, we accept the challenges of the ups and downs of a free economy, including the recession. We ask for no help from the government.

What we cannot understand is why the government would deliberately institute a policy that seems designed to single out our already depressed industry for extinction and for no good purpose.

Thank you.

Senator BREAUX. Thank you very much, Mr. McKenney.

[The prepared statement of Mr. McKenney appears in the appendix.]

Senator BREAUX. And finally, to wrap it up, Mr. Jeff Napier.

Mr. Napier.

STATEMENT OF JEFF NAPIER, PRESIDENT, NATIONAL MARINE MANUFACTURERS ASSOCIATION, CHICAGO, IL

Mr. NAPIER. Thank you, Mr. Chairman. And I would like to thank you, particularly, and Senator Chafee for your championing our cause and our jobs.

Let me depart from my written remarks, and if I may, introduce them into the record, along with supplemental material on job loss and a few statistics which I will provide to the committee.

Let me say that we are talking about 500 almost entirely small businesses spread throughout every State of the Union who are almost exclusively in the business of manufacturing boats subject to the tax. In addition, there are several score more who manufacture the larger boats, and as well, smaller boats.

These companies and their retail dealers—probably 2,000 in number—account for about 60,000 jobs, not counting the many after market service jobs, not counting a lot of the jobs connected with the components in the boats. So, in all, we are talking about more than 100,000 jobs just in this segment of the boating industry.

Let me underline the eloquent remarks of Mr. McKenney about the fact that we are talking about people's lives here—real, live people. All the statistics that I will provide you, and other witnesses have provided, take on meaning when you get to meet the people who are unemployed; people with mortgages, people with tuition, people with hopes and dreams who no longer have the jobs because of actions of their government.

Our witness this morning from the Treasury suggested that we ought to postpone any action until government data is available, perhaps in 2 or 3 years. Let me confirm that the industry that is now subject to this tax will be extinct by that time.

We are now seeing an increasing number of Chapter 11 filings. My guesstimate is that we will see quite a number of them in the next 3 to 6 months as these small businesses simply run out of capital and close their doors. Their capital has been very severely strained right now, and simply there is not going to be much more left to support these companies.

Our sales are down very significantly in this industry due to the recession. As a big ticket, discretionary income durable, we are probably the leadingest of the leading economic indicators, particularly in terms of an economic downturn. Our sales have been off over the last 2 years about 40 percent, and this is in all segments of our industry, including the smaller boats not subject to the tax. The 40 percent, I might add, typically tracks our historical record in a good, strong recession. That is about the bottom in a strong recession.

In the case of the larger boats subject to the tax, however, our sales are down not only 40 percent, but typically a minimum of 60 percent, and in the largest boats, as much as 80 percent.

So that suggests very strongly the difference between a recessionary effect on the one hand and, as to the bigger boats subject to the tax, recession plus the tax itself.

Fortunately, we do not have to wait 2 or 3 years to get the Treasury Department statistics on what the tax yield will be with updated data.

Our association is hiring a Big Eight accounting firm to basically use the Joint Tax Committee methodology to bring the data that was hastily put together last fall up-to-date, and we expect to be able to provide the committee with data on real tax yields, particularly for the out years, within the next 30 days. So, I think that will give us a better basis on which to proceed on this bill.

It seems to me that when you are talking about a product that has about a 50-percent labor component, and in addition, the after market with very strong service labor, that you cannot really say you are taxing the rich. What you are really doing is redistributing the wealth; you are creating jobs. And that is what is happening here. And to pooh-pooh it as a minor trickle down effect to workers really is to miss the point altogether. We are an extremely labor-intensive industry, so anything that is invested in a new boat, in fact, creates a lot of jobs.

Our industry is one of the very few U.S. manufacturing industries that has a favorable surplus of trade. Our favorable surplus of trade in 1990, according to the Commerce Department, was $600 million on exports of $1.1 billion. That creates a lot of U.S. jobs.

The reason that we are so successful internationally is because of our economies of scale in the domestic market. But, as the market goes down due to this tax, our competitiveness internationally goes down dramatically as well.

I think one of the earlier witnesses referred to the experience of the United Kingdom, which had a tax very similar to this tax—an excise tax. They virtually killed their industry, but fortunately, promptly repealed the tax when they discovered what they were doing.

A similar experience happened in Italy, and they, too, repealed their tax largely, and the result is they brought the jobs back before it was too late.

In summary, Mr. Chairman, let me say that this tax is bad economic policy, bad tax policy, because it does not yield net revenue. It is bad jobs policy, and it is bad trade policy, and it has to be repealed at the earliest possible date, because we are losing 100 jobs a day.

Thank you very much.

[The prepared statement of Mr. Napier appears in the appendix.]

Senator BREAUX. Well, I thank all the panel members for traveling and being with us from their respective States, and making their presentations.

I think there is no question that boat sales are down—boat sales in the category that are affected by the tax are down. The question is why? Dr. Zimmerman, in his testimony and the modeling that he has done suggests three possible explanations.

First was the Gulf War. Second was, perhaps, the market for luxury boats is saturated, and third, you mentioned could be the change in real disposable personal income has occurred, and therefore, fewer sales are made.

And then, Dr. Zimmerman, you point out that according to the model estimates, the large decrease in the boat sales is not attributable to either the luxury boat tax, or even changes in the real disposable personal income for the entire population.

Having eliminated some of those—what you feel to be the reasons, what would you offer as—or did your model show what would be the reason for the decline in the sales if it is not these that you have eliminated?

Dr. ZIMMERMAN. Well, I think if I were able to have my ideal information, I would like to have some information about what has happened to the income of the portion of the population that has the income and wealth to buy these large luxury boats, rather than the data available for the population as a whole.

And I suspect for 1989 and 1990 that the portion of the population that can buy these boats has suffered larger reductions in their disposable personal income than the rest of the population. And that if we had that number to look at and applied it to our knowledge of income sensitivity, we would find that would go a long way towards explaining the drop in boat sales.

We have the experience of both the Treasury Department and the Congressional Budget Office's capital gains realizations equations that predict capital gains realizations, way over-predicting in 1989, which I think has continued. And that is an important component of the income of these individuals.

So, if I add to my primary thinking, it is that the drop in income of that slice of the population has been very large with the real estate collapse, and that sort of thing.

Senator BREAUX. Certainly looking at that drop in income, plus the added 10-percent tax, combines to make it, I would think, worse. I am interested in you commenting on two points made by the witnesses. One of them, Mr. Napier, pointed out that looking at the sales in the Pacific Northwest, an area that has been relatively only minorly touched by the recession, that sales in the first quarter of these type of vessels would total about $29 million, and in the first quarter of this year when the tax is in place, it is only a $3 million worth of sales for the same vessels; a dramatic decline.

And then, I think Mr. Pearson pointed out that there has been a real stable, if not increase, in the amount of sales to foreign customers who are not subject to the tax. How do these factors affect your modeling estimates, if at all?

Dr. ZIMMERMAN. Well, with respect to the first issue, if you look at the average price of these luxury-class boats and actually work out what the effect of the tax is, it averages only about 4.2 percent. So, we are not talking about a 10-percent tax.

Senator BREAUX. That is 4.2 percent of the total price of the boat since the tax is only on the amount over $100,000.

Dr. ZIMMERMAN. Correct. Based on 1990 prices. So we are talking about a 4.2-percent tax, which even if we assume a relatively sensitive price response, would get you a 4.2-percent drop in sales. And the luxury portion of the industry is only about 34 percent of total industry sales, so you are talking about a third of 4.2 percent. So, even if we say my results are wrong and the industry is price sensitive, you cannot get there from here because of price changes.

Senator BREAUX. Are you saying that a 4.2-percent increase in the final price should result in only a 4.2 percent-reduction in sales?

Dr. ZIMMERMAN. That is right, if, indeed, you had what economists refer to as a unitary elastic demand curve. That is, a given percentage increase in price results in an equal percentage decrease in number of units purchased.

Senator BREAUX. I am not sure I understand all of that. I just think the average guy goes and is very marginal as to whether he can afford a boat, and he walks in and sees it almost 5 percent more than it was the day before, that is enough to turn off 100 percent of the potential buyers.

Dr. ZIMMERMAN. Well, I do not think if we look at the way people buy, that they totally eliminate their purchases of things when prices go up 4 or 5 percent. Or particularly, there may be an individual or a small portion of all individuals who react that way, they get so mad about a price increase. But when you add everybody in the economy making these purchases together, statistically, you are only going to get a small percentage of them making the decision not to purchase.

Senator BREAUX. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. I would just like to say, Dr. Zimmerman, that to repeat that noted philosopher, Yogi Berra, he said, "You can see a lot by looking." And the facts are that these folks who have testified, whether they are from Louisi-

ana or Rhode Island or Maine, have all testified that during previous recessions, their large boat sales have stood up and, indeed, that is what has carried them through those times.

The elasticity is far more on the lower end of the scale than the upper scale. That is, the elasticity in association with presumably prosperity. And so that when times are good, they sell the small boats and the big boats. When times are bad, they only sell the big boats, or fewer small boats than normally, but the big boats hold up.

So, those are the facts. And I think to suggest that the Gulf War, or something else is deterring people—I know you are searching for solutions—but I just think it flies in the face of the experience of these individuals who are not newcomers to the business. Maybe Mr. Chantrey has been in a relatively short time, but I suspect he has probably been associated with the business one way or another. But somebody like Mr. Pearson or the Hinckley folks have been there for years in this business.

And, furthermore, I think you have got to assess the options that are available to an individual to spend his money. You say if a $200,000 boat, a 10-percent tax is really only 5 percent on the total purchase price, but I do not think that people look at things that way. They look at it that doggone it, they are being hit with a 10-percent tax on the high-priced boat.

And Mr. Pearson, in his lengthy statement, pointed out as the others have, that people spend their money on condominiums, or vacation resorts, or whatever it might be—real estate—which for some curious reason is not considered a luxury.

But more than that, they can purchase a boat overseas and keep it there, and the 10 percent affords them the transportation back and forth. According to some there really is some enjoyment in keeping a boat in the Bahamas, or wherever it might be, and feeling that you are paying for it by not paying the tax on your U.S. boat. Such are the results that they are experiencing.

Dr. ZIMMERMAN. Well, do you want me to respond?

Senator CHAFEE. Well, it is more of a statement on my part, I suppose, than a question. But I wanted to get it off my chest. I have read your statement. I am not an economist, and I am sure that this is brilliantly done, but I must say I did not understand all of what you said.

Dr. ZIMMERMAN. Well, one thing I would like to add is that the tax that has been imposed, even if we assume it is 10 percent, and people behave as though it is 10 percent, if you look at the price changes in this industry since 1970, there have been 5 years where the average price of boats changed by somewhere between 9 and 10 percent up to 18 percent.

And in none of those instances did we get any kind of change in boat sales anything remotely like experienced in 1990, which suggests that, in fact, what is happening this year is probably not attributable to the price change.

Senator CHAFEE. Well, first of all, I will let them respond. But I suspect they have got the price increases, anyway. Materials are going up, help is going up, even though they, in Hinckley, they took a 10-percent wage cut. I suspect that for some of their people, certainly for their suppliers, I cannot believe they are selling a

boat—Hinckley Pilot—for the same price they were selling it 5 years ago, or 2 years ago. It has all gone up.

Well, Mr. Pearson, do you want to respond to that? And by the way, I think you can stress, Mr. Pearson, you were selling your expensive boats during some bad times. We have had some bad times.

Mr. PEARSON. I would like to say that we have had pretty close contact with out customers. When you are selling people these yachts that cost a lot of money, you have close contact with them, so we know what they are doing. And since this tax went into effect, we have had the actual buyers that we have been negotiating with just leave the marketplace. They have refused to pay the tax. Several have gone overseas; others are just sitting on the sidelines.

I think that the critical thing that faces our industry right now is that we do something, because we have so many buyers who now have heard about this repeal effort who absolutely will not be the last one to pay the luxury tax. So we need some action to get a decision made one way or another so we can get on with our business.

Senator BREAUX. Yes, Mr. Napier.

Mr. NAPIER. Senator, I would like to address, if I may, some of the remarks of Dr. Zimmerman. Let me first confirm that we do find them hard to accept. And I would suggest that it is sort of like a magic act. What you see in econometric modeling is not always what really happens in real life. And our real life experience over many years is that our elasticity factor is a 2 to 1 ratio, which is to say that for every 1 percent our price goes up for whatever reason, beyond the current cost of living or annual inflation rate, our sales go down by 2 percent.

So, if you have a price increase that stays within the cost of living or the inflationary cost increase, you are all right. In some years, in the last 20 years, our price increases were very great because inflation was very great, and that was pushing us. In most years we are—even in the big inflation years—we are within the inflation rate. And so, we do not have a drop off in sales.

If you slap on a 10-percent tax, what happens at that point is you are running way ahead of the inflation rate. And simply, sales drop off predictably, at 20 percent. And, indeed, that is exactly what has happened, except it is more than 20 percent.

The other factor is there is a leverage on this whole thing simply because of the fact that about two-thirds of all boats are financed in their purchase. The banks and other lending institutions will not finance the tax portion of the cost, because there is no collateral, no security behind it.

So, the result is if you are going to buy a boat, you have to come up with 10 percent extra on the front end and a lot of people simply will not do that.

Senator CHAFEE. Well, thank you, Mr. Chairman. I just want to stress the point that Mr. Chantey made in his testimony that these are not the rich and famous that are buying these boats. In many instances, they are professional people to whom this is a substantial investment that they think about, and when they are hit with an extra 10 percent, it is a real damper on the whole business.

And all we know, Mr. Zimmerman, is the facts. You have heard these gentlemen. I do not think there is any reason to dispute what they are telling us. Their sales have just gone south, and it is tragic. In our State I see it, and Mr. Pearson has recounted what has happened with his competitors who are in Rhode Island, people like Ted Hood and those people who build these great, big, expensive boats running up close to $600,000. Just once upon a time they would sell five or six a year; now they are selling zero.

Well, Mr. Chairman, I think the point that Mr. Napier made is a good one about nobody wants to be the last one to pay the tax, and this has thrown a good deal of uncertainly. In our legislation, we do provide for better or ill, that it is retroactive. When we remove this tax—and I hope I am accurate when I say when we remove it—it will be retroactive to January 1, 1991.

Senator BREAUX. Right. Well, I also want to join with Senator Chafee in thanking the panel. I think you have made some very good and cogent points in the real world. I appreciate Dr. Zimmerman's model. He put a lot of effort and time into it. The fact that we do not necessarily agree with it does not mean we do not appreciate the work and effort that he put into it.

But I think that in the real world that we are hearing from these people who are telling us what is actually happening out there. I do not think the modeling takes into consideration the emotions that go into a decision to purchase a luxury yacht. And that, obviously, I think, has been drastically affected by the tax, and I do not think we are going to get the money out of it that anybody hoped for is the second reason.

So, we thank the panel very much, and appreciate your being here today.

Gentlemen, let me go ahead and make an announcement that you are not going to like, but the committee is going to have to take a recess so that the committee room can be set up for the next hearing.

Therefore, this panel will be heard following the next panel, which begins at 2:00.

[Whereupon, the hearing was recessed at 1:42 p.m.]

AFTER RECESS

Senator BRADLEY. Mr. William Hoffman from Carson City, Nevada; Mr. Harley Duncan from here in Washington; Mr. John Killian, Library of Congress. This is a panel that came to Washington to testify on Senator Reid's State Taxation of Non-Resident Pension Income. Little did you know you would leave Washington as experts on capital flight.

I want to apologize to you, because I do have another meeting. So I hope that you will summarize your testimony in a few minutes, and take your full testimony for the record. I, personally, am very sensitive to the issue. Mr. Hoffman, you want to be first? I am going to be ruthless here and try to see if I can hold you to 2 or 3 minutes. You have come a long way, and I apologize, but I have been asked to do this—to hold you to 2 or 3 minutes.

STATEMENT OF WILLIAM C. HOFFMAN, PRESIDENT, RESIST OF AMERICA, CARSON CITY, NV

Mr. HOFFMAN. All right. I will try my best, Senator. Good afternoon Senator. My name is Bill Hoffman. I am currently the President of RESIST of America, and I want to thank the committee for hearing S. 267 and inviting me to speak for it. Now, I realize it is going to be difficult to cover this issue completely in a few minutes. I will do my best to hit the highlights.

Senator BRADLEY. Assume the committee knows the issue. Why is this a good thing to do? That is the best way.

Mr. HOFFMAN. Well, I wanted to first bring out some of the highlights. The lady that Senator Bryan mentioned that makes about $13,000 a year and was hit by California for enormous taxes, they did say she could pay $50 a month. But she had to decide could she pay the gas bill, or could she pay the $50. She decided she could not pay the tax, and so California went all the way back to 1978 and increased her tax liability to $6,000.

And then, if you can imagine a man in New York whose wife died, who meets a lady, marries her, and moves to New York because his new wife is working there, he discovers he has to pay California taxes not just on his pension for the rest of his life, but on his total income and his new wife's total income. And he pays New York much less, because they have a very favorable resident tax exemption. And I do not think you can blame him for being angry.

A lady in Tyler, Texas just recently received a bill from California for more than $24,000. That is quite a shock. Unfortunately, none of these are imaginary cases, and they are just a few cases out of thousands in our file.

What can we do to stop this unfair practice? Source taxes, unfortunately, were declared Constitutional some 70 years ago. I will not go into the cases, but they occurred at a time before pensions were common.

Now, we have been trying and are trying to work the problem at the State level, as some of the Senators have suggested. New Jersey is the only State that has repealed this resident tax.

We had legislation introduced in California both last year and this year, and we were treated last year as true non-residents by the California legislature, and not allowed to testify, even though we were invited. They claimed they was not enough time, even though an ostrich barbecue and a debate took over 4 hours involving maybe three people. This year, Dick Millington, vice president of NARFE, received the same treatment. Now, we still have not given up, but I am not optimist on that score.

We have stop-gap measures introduced in four States to prevent the seizure of property by collection agencies for the collection of these taxes. Nevada, Florida, Utah, and Washington State have passed this legislation. Arizona, Hawaii, and Oregon have pending legislation. There are a number of other States considering it—I think Texas is one of them—and it is clear that an economic war between the States has begun.

Now, what can we do about this? Where can we turn for help? We believe we can only turn to you, the Congress of the United

States. You are our last hope. You might ask what about States' rights? Well, we believe in States' rights, but we also believe that States' rights end at their borders. When borders are crossed, individual rights must be protected by the Federal Government.

Now, bill S. 267 does not cost the Federal Government one red cent. They will get some added revenue. We can show that there is no ultimate loss to the States, either. Everyone should pay tax to their resident State where they can vote, petition, are represented, and get services and benefits.

With the millions of people in our coalition, I urge you to pass S. 267, a bipartisan bill, with no cost impact on either the Federal Government or the States, stop taxation without representation, an issue that caused our Revolution, and stop this injustice to seniors and future seniors. After all, this tax affects everyone, even the employee who has no pension or never leaves the State where the pension is earned.

Thank you very much for the time.

[The prepared statement of Mr. Hoffman appears in the appendix.]

Senator BRADLEY. Thank you, Mr. Hoffman.

Mr. Killian.

STATEMENT OF JOHN KILLIAN, SENIOR SPECIALIST, AMERICAN CONSTITUTIONAL LAW, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS, WASHINGTON, DC

Mr. KILLIAN. Mr. Chairman, I am John Killian, Senior Specialist, American Constitutional Law at the Congressional Research Service, and I am appearing by invitation of the committee to address the sole issue of the Constitutionality of S. 267. I have no opinion, nor can I express any views, about the policy issue whether Congress should or should not pass the legislation.

The sole issue of the Constitutionality is, unlike a lot of Constitutional questions, easily resolved here. Congress clearly has the power under its power to regulate interstate Commerce to enact laws which displace State laws, including tax laws.

There are clearly interstate transactions involved here. The retirees have moved in interstate commerce. The pension benefits, by definition, move in interstate commerce when they are paid through the mails or by electronic transfers, and the like.

There is substantial case law to the effect to the effect that Congress, when it chooses to regulate commerce, need not merely supplement what the Constitution would prohibit. The fact that these tax laws may be Constitutional is of no moment to Congress' decision to abolish them. There is case law to establish the Congress has the power to make its own determinations on the basis of its own sense of policy and judgment and fairness and the like to determine that there is an interference of commerce beyond what the Constitution would prescribe, and to legislate to prohibit it. Neither is there a problem with respect to the fact that there are only a few States involved here; perhaps five, perhaps a few more.

One of the cases that is involved and I cite in my memorandum to the committee involved a dispute between New Mexico and Arizona in which Arizona prevailed at having Congress abolish or

outlaw a New Mexico tax on the generation of electricity which was produced in New Mexico and sold in Arizona.

And the Supreme Court unanimously held that Federal statute to be unconstitutional, unanimously held that it did go beyond what the commerce clause required, and that Congress was well within its rights to enact it.

So, in this instance, I think I can advise the committee that there is no Constitutional difficulty at all in enacting this legislation.

[The prepared statement of Mr. Killian appears in the appendix.]

Senator BRADLEY. Thank you very much, Mr. Killian.

Mr. Duncan.

STATEMENT OF HARLEY T. DUNCAN, EXECUTIVE DIRECTOR, FEDERATION OF TAX ADMINISTRATORS, WASHINGTON, DC

Mr. DUNCAN. Thank you, Mr. Chairman. I am with the Federation of Tax Administrators, an association of State tax agencies, and we oppose enactment of S. 267 and other similar measures that would limit State taxation of non-resident income. We do so for several reasons.

Foremost, S. 267 would disrupt the underlying principle of State income tax systems, namely, that income is to be taxed where it is earned, and that States may tax the income from all sources within the State.

The source tax principle is important to the sovereignty of the States and to our Federal system. Without the ability to tax incomes from in-State activities, certain taxpayers may avail themselves of the State marketplace and services without assisting in the financing of those in proportion to that income.

The States are not unfettered in this regard. They are bound by the Constitution. In particular, the taxation of non-resident income, as has been mentioned, was upheld 70 years ago. States have to meet three tests. It has to be limited to the in-State income, it has to pass the due process standards and not have double taxation, and it cannot be discriminatory toward the non-residents. We think that the States do this through the manner in which it is computed and a universal system of offsetting credits for taxes paid to other States.

We believe that S. 267 would create inequities of its own. Importantly, it would take what is intended to be a tax deferral and convert it to a tax exemption for those retirees who had the ability and desire to move to a non-income tax State.

It would create inequities between two people who work in a State their entire life and their lifetime burden on that income would differ. It would also create situations in which it would be advantageous for certain high-income people to defer large amounts of income in their latter years, move to a non-income tax State, and received that on a deferred, non-tax basis.

Finally, we think that the taxation of non-resident income is a matter of State tax policy that is best decided by State Legislatures. It needs to be considered as a part of overall State tax policy, balanced with other issues, such as the taxation of non-resident income generally, the taxation of retirement income, the economic

and demographic characteristics of the State, the administration of the tax, and the like. A variety of interests have to be balanced. We think that is better done at the State level rather than through a blanket prohibition such as proposed in S. 267. The States have done this in the manner in which they have addressed the taxation of non-resident incomes. Some exempt significant portions of it, others do not.

In addition, while this gentleman believes that it is Constitutional, earlier Congressional Research memoranda were not so explicit and said that there were some reservations that needed to be looked at. At the very least, we would have to agree that it is a substantial expansion of congressional authority into the definition of what is taxable and what is not for the States.

The only other three instances that the Congress has stepped into this area are with respect to Armed Services personnel, members of Congress themselves, and intrastate commerce workers of railway and motor carriers. We think it is inadvisable for the Congress to move further. Thank you.

Thank you.

Senator BRADLEY. Thank you all three very much. Mr. Duncan, I just want to clarify something. So that your view is someone that lives in New Jersey and commutes to New York ought to pay taxes on the income earned in New York to New York?

Mr. DUNCAN. That is correct, sir.

Senator BRADLEY. If a retired person works for the State Police in New York, retires, and decides to move to the Jersey shore, your view is that New York State should still be able to tax that pension?

Mr. DUNCAN. That is correct, sir. It is income arising from services performed in New York. New Jersey also has a right to tax the income under both of those situations, and included in that tax base. Through a system offsetting credits, however, there is no double taxation on the income.

Senator BRADLEY. To the extent of your liability in New Jersey.

Mr. DUNCAN. That is correct. You would end up paying——

Senator BRADLEY. If you happen to live next to a high-tax State, and one of the reasons you decide to retire on the Jersey shore is because it is low tax, are you saying that one of the reasons that you would have moved to retire on the Jersey shore is taken away from you because the long arm of the New York State Department of Treasury reaches into your pocket and taxes you, so-to-speak?

Mr. DUNCAN. The effect of the offsetting credits is that you are taxed at the higher rate where you earned it, or where you live. It would go to the point that it is income derived from services performed in the State of New York.

Senator BRADLEY. But from your standpoint, if New York State voluntarily chose to give up the right to tax those State pensions of individuals who move to New Jersey as opposed to those who move to Connecticut, or California, that would be all right with you?

Mr. DUNCAN. The State of New York can choose to tax that which it desires. In fact, with respect to retirement income, it has very liberal approach.

Senator BRADLEY. Mr. Hoffman, your view is that this is outrageous that these senior citizens are being taxed, right?

Mr. HOFFMAN. Well, I think it is my view that it is outrageous that the States have taxed them in the manner in which they have. Now, we realize we were not told, some of our companies, States agencies, and so forth, did not pay taxes to the States on their contributions.

We, of course, paid taxes on our contributions. And I think most of us would be willing to pay if they had told us this and set up a fund like a 401 K and allowed you to settle when you left the State. That might have been appropriate. But to be taxed without representation for the rest of our life is outrageous.

Senator BRADLEY. Did they never tell you, Mr. Hoffman?

Mr. HOFFMAN. We have never been told.

Senator BRADLEY. They never tell you. Nobody will tell you.

Mr. HOFFMAN. No.

Senator BRADLEY. And then it comes in the mail, you owe the $24,000 and you are the little old lady in Texas, right?

Mr. HOFFMAN. Could I speak to the equal treatment that Mr. Duncan mentioned about?

Senator BRADLEY. Sure. Speak fast. We have about 2 minutes.

Mr. HOFFMAN. All right. Well, one of the things which is very unequal about this is the States like California have a very haphazard way of contacting people, so some people pay——

Senator BRADLEY. Well, put New York in there, too, now, Mr. Hoffman.

Mr. HOFFMAN. All right. And New York. And some people pay, and some do not pay. I think that is unequal. What is good for one should be good for another, and I think that only the Federal Government is going to sort this out. I heard Senator Reid's answer to your question, and I agree with what he said. But if you notice, our acronym stands for Retirees to Eliminate State Income Source Tax. If I thought that were possible, I would have tackled that problem. I think that there are inequalities in this entire source tax——

Senator BRADLEY. Yes.

Mr. HOFFMAN [continuing]. That only the Federal Government can handle.

Senator BRADLEY. Mr. Duncan, is this really happening because States now have more sophisticated taxing mechanisms?

Mr. DUNCAN. With respect to taxation of non-resident pension income, there has not been a great deal of movement in recent years. And the fact that one——

Senator BRADLEY. You mean before the computer everybody was sent a little piece of paper—this lady in Texas—saying you owe them $24,000?

Mr. DUNCAN. The ability to enforce the tax law on non-resident income has significantly improved——

Senator BRADLEY. Right.

Mr. DUNCAN [continuing]. With information reporting and computers, that is correct.

Senator BRADLEY. So, what we are doing is we are reaching out and touching more people.

Mr. HOFFMAN. That is right. All the way to Saudi Arabia, Senator.

Senator BRADLEY. Well, this is a very interesting issue. As I say, it is not my bill, but it is an issue that I am familiar with. I am pleased that you have had a chance to present your case.

And Mr. Killian, I might call on you to come back and make more constitutional arguments. I do not think this is going to come down to a Constitutional question—just my hunch—the way this is developing. But I appreciate your willingness to come over, and CRS is always a very valued institution for the Congress as a whole.

Thank you very much. And the subcommittee is adjourned.

[Whereupon, the hearing was adjourned at 4:25 p.m.]

APPENDIX

Additional Material Submitted

Prepared Statement of Senator David L. Boren

Ladies and gentlemen, this hearing of the Subcommittee on Taxation has been scheduled to consider testimony relating to six different bills:

S. 90, the Environmental infrastructure Act, by Senator Domenici—to modify the tax-exempt bond and depreciation rules with respect to infrastructure facilities;

S. 913, the Tax Exempt Bond Simplification Act, by Senator Baucus—to increase the amount of bonds eligible for certain small-issuer exceptions and to modify other tax rules with respect to bonds issued by state and local governments;

S. 150, the Higher Education Tax Exempt Bond Reform Act, by Senator Moynihan—to treat bonds issued for section 501(c)(3) organizations in a manner similar to government bonds;

S. 649, by Senator Breaux—to repeal the luxury excise tax on boats;

S. 284, the Living Benefits Act, by Senator Bradley—to amend the tax treatment of payments under life insurance contracts for terminally ill individuals;

S. 267, by Senator Reid—to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that state.

We have a large number of valuable witnesses scheduled to testify today, including several members of Congress who feel strongly about one or more of these bills. We are also pleased to be joined by several state and local government officials who can tell us first-hand about the struggle they face in financing their operations.

Let me make one comment about the Domenici and Baucus bills, which will be addressed together today by our panelists. The bottom line is that the federal government continues to impose mandates on state and local governments, especially through environmental standards. Some of these requirements are reasonable, many are excessive, most are expensive to achieve.

It is likely that this Congress will see this trend continue as it rewrites the Resource Conservation and Recovery Act (RCRA) and the Clean Water Act. The current debate on education policy may result in additional requirements on the states. it is obvious that the federal government will be unable to provide large amounts of direct assistance to local governments because of our budget problems.

Therefore, many of us believe that we can get a greater bang for the federal buck through changes in the tax codes that help state and local authorities raise the money necessary to meet these needs through the issuance of tax-exempt bonds. With this general goal in mind, I look forward to the testimony we will hear today.

Attachment.

Statement of the U.S. General Accounting Office

Mr. Chairman, you have asked us to prepare a statement for the record about our ongoing evaluation of the policy and administrative issues associated with luxury excise taxes. We are pleased to provide the Subcommittee with information on what we plan to accomplish in this area. We are doing this work at the request of Congressmen Hughes, Guarini and Saxton, and Senators Bradley and Lautenberg.

As you know, Congress enacted luxury excise taxes that generally took effect on January 1, 1991. These taxes are levied on the first retail sale of five products: boats costing over $100,000, cars costing over $30,000, airplanes costing over $250,000, and

jewelry and furs costing over $10,800. The seller remits the excise tax to IRS, which is 10 percent of the price over these threshold amounts. Parts and accessories installed within 6 months after a vehicle is placed in service may be taxable, and some uses (such as for business purposes) are exempt.

In examining these new taxes, our objectives are to:

—evaluate IRS' current efforts and future plans to collect luxury excise taxes,
—identify compliance and policy issues arising from the design of the tax,
—estimate the relative tax incidence on producers and consumers of these products, and
—examine the impact on the boating industry.

To provide some general background, we will describe the current luxury excise taxes and describe IRS' efforts to implement the tax, including its efforts to inform taxpayers about the new taxes and process the returns. We will obtain data from the first quarterly filing results from returns filed by April 30, 1991.

In evaluating the administrative issues associated with the luxury excise taxes, we will assess IRS' examination plans and, to the extent they are available, early audit results. If possible, we will attempt to estimate the costs to IRS in administering the tax. We will also review public comments on the proposed regulations implementing the tax to determine what provisions may be causing problems.

We also will evaluate policy issues arising from the design of the tax, such as definitional ambiguities in products covered and the exclusion of some used products from the tax. To determine the relative incidence of the luxury excise tax, we will obtain and analyze data on prices, labor costs, and income over time to calculate supply and demand elasticities for each of the five luxury products. These measures will help show how responsive demand is to price changes, such as tax increases. They will also permit us to estimate what portion of the tax will be passed on to consumers or absorbed by manufacturers. We can then be in a position to assess what portion of the tax burden falls on producers and on consumers.

An analysis of these measures should help in determining whether reported decreases in luxury item sales are due in part to the taxes and whether Congress' intent that wealthy consumers bear the burden of the tax is being achieved. We also will use this information on relative tax burden, along with other industry information, to develop an indication of the impact on each taxed industry. An important analytical question here involves sorting out the impact of the taxes from other factors likely to affect product sales, such as the general economic climate and credit availability. Although we will attempt to control for the impact of these other factors, precision is unlikely and we may not be able to quantify the impact of the tax alone.

Finally, due to our requestors' interest in the boating industry, we will study this industry in more detail. We plan to look at the number of businesses starting up and going out of business over time, interview industry members regarding the tax, and attempt to obtain information about employees and their job prospects. We will attempt to assess the significance of the luxury excise taxes relative to other broader economic trends affecting sales in this industry.

We are in the design phase of our work, where we investigate what data is obtainable and make decisions about what information we will be able to develop in our analysis. We plan to reach this decision point in mid-July. By that time, we will determine the character and format of our final product. At a minimum, we anticipate briefing our requesters on our analyses by mid-September 1991.

[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS (S. 90, S. 150, S. 267, S. 284, S. 649, AND S. 913)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION

OF THE

SENATE COMMITTEE ON FINANCE

ON JUNE 12, 1991

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Subcommittee on Taxation of the Senate Committee on Finance has scheduled a public hearing on June 12, 1991, on six tax bills: (1) S. 90 ("The Environmental Infrastructure Act of 1991"); (2) S. 150 ("The Higher Education Tax-Exempt Bond Reform Act of 1991"); (3) S. 267 (relating to State taxation of pension income of nonresidents); (4) S. 284 (relating to the treatment of payments under life insurance contracts for terminally ill individuals); (5) S. 649 (repeal of the luxury excise tax on boats and yachts); and (6) S. 913 ("The Tax-Exempt Bond Simplification Act of 1991").

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary and description of the six tax bills scheduled for the June 12 Subcommittee hearing.

The first part of the pamphlet is a summary of the bills. The second part is a description of each bill, including present law, explanation of the bill and effective date, and the principal issues relating to the bill.

[1] This pamphlet may be cited as follows: *Description of Tax Bills (S. 90, S. 150, S. 267, S. 284, S. 649, and S. 913)* (JCS-7-91), June 7, 1991.

I. SUMMARY

1. S. 90 (Senators Domenici, Boren, Symms, and Others): "The Environmental Infrastructure Act of 1991"

Tax-exempt bonds

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (Code sec. 103). Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties if (1) the financed activities are specified in the Code and (2) at least 95 percent of the net proceeds of the bond issue are used to finance the specified activity. Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Among the infrastructure-type activities of private businesses for which tax-exempt bonds may be issued are: (1) airports, docks and wharves, mass commuting facilities or high-speed intercity rail facilities; (2) water, sewage, solid waste, or hazardous waste disposal facilities; (3) facilities for the local furnishing of electricity or gas; and (4) local district heating or cooling facilities.

All tax-exempt bonds are subject to arbitrage restrictions, including a requirement that profits on most nonpurpose investments be rebated to the Federal Government.

S. 90 would liberalize several of the tax-exempt bond rules. First, the bill would create a new type of tax-exempt bond between governmental and private activity bonds, called "infrastructure facility bonds." Bonds for infrastructure facilities (largely facilities currently eligible for private activity bond financing) would not be subject to the restrictions currently applicable only to private activity bonds. Among the restrictions that would not apply are: (1) State volume limitations; (2) treatment of interest on such bonds as a preference item under the individual and corporate alternative minimum taxes; (3) prohibition of the advance refunding of these bonds; (4) application of the change-in-use restrictions on such facilities; (5) limitation on bond-financed issuance costs; (6) maturity limits; and (7) public hearing and approval requirements applicable to private activity bonds.

Second, the bill would create an exception from the arbitrage rebate requirement for all governmental and infrastructure facility bonds, if prescribed percentages of the gross proceeds are spent within specified time limits. To qualify for this exception, at least 20 percent of the gross proceeds of the issue must be spent within one year after issuance, at least 50 percent within two years after issuance, and at least 95 percent within three years of issuance.

Capital cost recovery

Present law generally prescribes accelerated cost recovery periods and methods for most tangible property.

The bill would assign a seven-year ACRS recovery period, and a 10-year ADR midpoint, to all infrastructure facility property which does not already have a shorter recovery period and ADR midpoint, and would make other changes to the cost recovery rules.

Effective dates

The tax-exempt bond provisions of the bill would apply to bonds issued after December 31, 1991. The capital cost recovery provisions of the bill would apply to property placed in service after December 31, 1991.

2. S. 150 (Senators Moynihan, Danforth, Boren, Chafee, Pryor, Daschle, Symms, and Others):

"The Higher Education Tax-Exempt Bond Reform Act of 1991"

Present law generally excludes from income interest on State and local government bonds if the bonds are issued to finance direct activities of these governments (sec. 103). Interest on bonds issued by States and local governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is included in the Code. One such exception is for private activity bonds issued to finance activities of charitable organizations described in section 501(c)(3) ("section 501(c)(3) organizations") when the activities do not constitute an unrelated trade or business (sec. 141(e)(1)(G)).

Before enactment of the Tax Reform Act of 1986, State and local governments and section 501(c)(3) organizations were defined as "exempt persons" under the Code, and their bonds generally were subject to the same requirements. As exempt persons, section 501(c)(3) organizations were not treated as "private" persons, and their bonds were not "industrial development bonds" or "private loan bonds" (the predecessor categories to current private activity bonds).

Section 501(c)(3) organizations also may not benefit from more than $150 million per institution of outstanding tax-exempt bonds.

S. 150 would amend the tax-exempt bond provisions of the Code to conform generally the treatment of section 501(c)(3) organization bonds to that provided for bonds issued to finance direct State or local government activities. The principal substantive effect of the bill would be the repeal of the $150 million per institution limit on outstanding nonhospital bonds for 501(c)(3) organizations.

Effective date.—The bill would apply generally to bonds issued after the date of enactment.

3. S. 267 (Senators Reid, Bryan, Symms, and Others):

State Taxation of Pension Income of Nonresidents

Under present law, State taxation of retirement income varies from State to State. Effective for taxable years beginning after December 31, 1991, S. 267 would prohibit any State from imposing

income tax on the pension or retirement income of nonresidents of the State.

4. S. 284 (Senators Bradley, Symms, Grassley, Chafee, Danforth, Baucus, Breaux, Packwood, Roth, and Others):

Treatment of Payments Under Life Insurance Contracts for Terminally Ill Individuals

Under present law, amounts received under a life insurance contract prior to the death of the insured generally are includible in the gross income of the recipient to the extent that the amount received exceeds the recipient's investment in the contract. Effective for taxable years beginning after December 31, 1989, S. 284 would exclude from gross income amounts received by an individual under a life insurance contract if the insured under the contract is terminally ill.

In addition, in determining whether a contract qualifies as a life insurance contract for Federal income tax purposes, S. 284 would treat a qualified terminal illness rider as a qualified additional benefit. The bill would also provide that the addition of a qualified terminal illness rider to a life insurance contract would not be treated as a modification of, or material change to, the contract for purposes of the definition of a life insurance contract and the definition of a modified endowment contract. Further, for purposes of the rules that apply to life insurance companies, a qualified terminal illness rider would be treated as life insurance. These provisions of the bill would be effective for taxable years beginning before, on, or after December 31, 1989.

Finally, effective on January 1, 1990, the bill would provide that applicants for, and recipients of, benefits under certain public assistance programs would not be required to take into account the right to receive an accelerated death benefit in determining eligibility for the public assistance benefits.

5. S. 649 (Senators Breaux, Chafee, Pell, and Others):

Repeal of the Luxury Excise Tax on Boats and Yachts

S. 649 would repeal the 10-percent luxury excise tax applicable to boats and yachts. The excise tax currently applies to the portion of the retail price that exceeds $100,000. The repeal would be effective retroactive to January 1, 1991 (the effective date of the tax under the Omnibus Budget Reconciliation Act of 1990).

6. S. 913 (Senators Baucus, Dodd, Riegle, and Boren):

"The Tax-Exempt Bond Simplification Act of 1991"

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (sec. 103). Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties, if

the financed activities are specified in the Code. Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Issuers of all tax-exempt bonds generally are subject to two sets of arbitrage restrictions on investment of their bond proceeds. These restrictions are a yield restriction requirement, and a requirement that certain profits on nonpurpose investments be rebated to the Federal Government.

S. 913 makes numerous changes to the requirements governing issuance of tax-exempt bonds. Among the changes are: (1) repeal of a limit on unrelated and disproportionate private business use; (2) liberalization of the arbitrage yield restriction and rebate requirement; and (3) expansion of an exception from a financial institution interest deduction disallowance for smaller governmental units.

Effective date.—The bill generally would be effective for bonds issued after December 31, 1990.

II. DESCRIPTION OF THE BILLS

1. S. 90 (Senators Domenici, Boren, Symms, and Others): "The Environmental Infrastructure Act of 1991"

Present Law

a. Tax-exempt bonds

In general

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (Code sec. 103). Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties if (1) the financed activities are specified in the Code and (2) at least 95 percent of the net proceeds of the bond issue are used to finance the specified activity. Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Private activity bonds are bonds (1) more than 10 percent of the proceeds of which satisfy a private business use and payment test, or (2) more than five percent ($5 million, if less) of the proceeds are used to finance loans to persons other than State or local government units. A special restriction limits to no more than five percent the amount of bond proceeds that may be used in a private business use that is unrelated to direct governmental activities also being financed with a bond issue. This five-percent restriction is known as the "unrelated and disproportionate private business use limit."

Interest on the following private activity bonds qualifies for exclusion:

(1) Exempt-facility bonds;

(2) Qualified mortgage and qualified veterans' mortgage bonds;

(3) Qualified small-issue bonds;

(4) Qualified student loan bonds;

(5) Qualified redevelopment bonds; and

(6) Qualified 501(c)(3) bonds.

Exempt-facility bonds are bonds the proceeds of which are used to finance the following: airports, docks and wharves, mass commuting facilities, or high-speed intercity rail facilities; water, sewage, solid waste, or hazardous waste disposal facilities; facilities for the local furnishing of electricity or gas; local district heating or cooling facilities; and certain low-income rental housing projects.

Additional restrictions on private activity bonds

The Code imposes several restrictions on private activity bonds that generally do not apply to bonds issued to finance direct activities of States and local governments. The more significant of these private activity bond restrictions are described below.

State volume limitations

States are subject to annual issuance limits of the greater of $50 per resident or $150 million on the volume of private activity bonds they may issue. These volume limitations do not apply to qualified 501(c)(3) bonds and to exempt-facility bonds for airports, docks and wharves, and governmentally owned solid waste disposal facilities. Additionally, only 25 percent of exempt-facility bonds for qualified high-speed intercity rail facilities are subject to the volume limits, and qualified veterans' mortgage bonds are subject to separate volume limitations based on historical issuance by the five States authorized to issue such bonds.

Alternative minimum tax treatment

Interest on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986, is a preference item for both the individual and corporate alternative minimum taxes.

No advance refundings

Most private activity bonds may not be advance refunded. An advance refunding is the issuance of refunding bonds without redemption of the refunded (original) bonds within 90 days. Governmental bonds and qualified 501(c)(3) private activity bonds may be advance refunded one time.

Change-in-use restrictions

Beneficiaries of private activity bonds are subject to special interest deduction disallowance rules if the use of the property financed with the bonds is changed to a use not qualifying for tax-exempt financing while the bonds remain outstanding.

Bond-financed costs of issuance

No more than two percent of the net proceeds of a private activity bond issue may be used to finance the cost of issuing the bonds, and these amounts are not counted in determining whether the bonds satisfy the requirement that at least 95 percent of the net proceeds of each bond issue be used for the activity qualifying the bonds for tax exemption.

Maturity limit

The weighted average maturity of private activity bonds may not exceed 120 percent of the average economic life of the property financed with the bonds. (Unlike governmental bonds, private activity bonds other than qualified 501(c)(3) bonds may only be used to finance property as opposed to operating expenses or working capital.)

Public approval

A public hearing must be held and an elected public official must approve private activity bonds before they are issued (or the bonds must be approved by voter referendum).

Additional restrictions on all tax-exempt bonds

Arbitrage restrictions

In general, issuers of all tax-exempt bonds generally are subject to two sets of restrictions on investment of their bond proceeds. As explained more fully below, the two sets of restrictions generally apply with respect to different time periods following issuance of the bonds.

Yield restriction requirement.—Tax-exempt bonds proceeds generally may not be invested at a yield materially higher than the bond yield, i.e., only limited arbitrage profits may be earned. Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds (generally prescribed in Treasury Department regulations). Additional exceptions are provided throughout the term of the issue for bond proceeds invested as part of a reasonably required reserve or replacement fund and for a "minor" portion of the issue proceeds.

Unlike the rebate requirement, described below, the yield restriction requirement applies both to investments unrelated to the purpose of the borrowing ("nonpurpose investments") and to investments such as a loan to the ultimate borrower of the bond proceeds in the case of private activity bonds ("purpose investments").

Rebate requirement.—Generally, all arbitrage profits earned on nonpurpose investments of bond proceeds during periods when such earnings are permitted (e.g., temporary periods) must be rebated to the Federal Government. Permitted arbitrage profits on purpose investments (limited by the yield restriction requirement described above) are not subject to the rebate requirement. Present law also includes three principal exceptions to the rebate requirement on nonpurpose arbitrage profits.

First, if all gross proceeds of an issue are spent for the purpose of the borrowing within six months after the bonds are issued, no rebate is required. This exception may be satisfied notwithstanding the presence of a reasonably required reserve or replacement fund if all proceeds other than those invested as part of that fund are so spent and arbitrage profits on the reserve fund (and any bona fide debt service fund subject to rebate) are rebated.

Second, no rebate is due in the case of certain construction bond issues if the available construction proceeds are spent for the purpose of the borrowing at least at specified rates during the 24-month period after the bonds are issued. Construction bonds eligible for this exception include all governmental bonds, qualified 501(c)(3) bonds, and private activity bonds the proceeds of which are used to finance property owned by a governmental unit.

Third, bonds, other than private activity bonds, issued by governmental units having general taxing powers are not subject to the rebate requirement if the governmental unit (and all subordinate units) issues $5 million or less of governmental bonds during a calendar year.

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Tax treatment of financial institutions investing in tax-exempt bonds

Banks and other financial institutions generally are denied a deduction for the portion of their interest expense (e.g., interest paid to depositors) that is attributable to investments in tax-exempt bonds acquired after August 7, 1986. This disallowance is computed using a prorata formula that compares the institution's average adjusted basis in tax-exempt bonds acquired after that date with the average adjusted basis of all assets of the institution.

An exception to this prorata disallowance rule is permitted for governmental bonds and qualified 501(c)(3) bonds issued by or on behalf of governmental units that issue no more than $10 million of such bonds during a calendar year.

b. Capital cost recovery

In general

Accelerated cost recovery system

For regular income tax purposes, present law generally allows accelerated cost recovery deductions for tangible personal property and for real property (other than land) that is used in a trade or business or for the production of income (sec. 168). Personal property generally is classified according to its present class life (or "ADR midpoint") and assigned to one of seven cost recovery classes: three-year, five-year, seven-year, 10-year, 15-year, and 20-year classes. Real property is assigned to a 27.5-year (residential rental) or a 31.5-year (nonresidential rental) class. These classes generally are shorter than the applicable ADR midpoint for the property included in the class.

The method used to calculate cost recovery deductions likewise is accelerated for personal property. The cost recovery method applicable to property included in classes having recovery periods under 15 years is the double declining balance method, switching to the straight-line method at the time that maximizes the cost recovery allowance. For property in the 15-year and 20-year classes, the applicable method is the 150-percent declining balance method switching to the straight-line method at the time that maximizes the cost recovery allowance. The cost of real property is recovered using the straight-line method.

Alternative cost recovery system

An alternative cost recovery system is provided for property that is (1) leased to or otherwise used by a tax-exempt entity ("tax-exempt use" property), (2) financed with the proceeds of tax-exempt bonds, (3) predominately used outside the United States, or (4) imported from a foreign country with respect to which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts. Additionally, taxpayers may elect to decelerate cost recovery deductions on other property through use of the alternative cost recovery system. The alternative system also is used for computing a corporation's earnings and profits.

The recovery period under the alternative system generally is equal to the property's ADR midpoint life (12 years for personal property with no ADR midpoint life and 40 years for real property). The recovery method under the alternative system is the straight-line method.

Explanation of the Bill

a. Tax-exempt bonds

In general

S. 90 would create a new type of tax-exempt bond between governmental and private activity bonds, called "infrastructure facility bonds". Bonds for infrastructure facilities would not be subject to the restrictions currently applicable only to private activity bonds.

Further, the bill would substitute a three-year spending requirement for the arbitrage rebate requirement in the case of governmental bonds and the new infrastructure facility bonds.

Expanded financing eligibility and elimination of present private activity bond restrictions

Under the bill, certain facilities for which private activity exempt-facility bonds currently may be issued would be eligible for financing with the new category of infrastructure facility bonds. These facilities would include sewage and solid waste disposal facilities, hazardous waste disposal facilities, and facilities for the furnishing of water. In addition, infrastructure facility bonds could be issued to finance any other facility that was "constructed, reconstructed, rehabilitated, or acquired" to assist a State or local government in complying with any Federal statute or regulation administered by the U.S. Environmental Protection Agency. This authorization is not restricted to existing statutes or EPA regulations.

Because the facilities eligible for financing with infrastructure facility bonds (other than the unspecified facilities for EPA compliance activities) generally may be financed under present law, the principal substantive effect of the bill would be to eliminate application of the following private activity bond restrictions to these financings:

(1) Application of State volume limitations on the issuance of these bonds, other than for governmentally owned solid waste disposal facilities which are exempt under present law;

(2) Treatment of the interest on such bonds as a preference item under the individual and corporate alternative minimum taxes;

(3) Prohibition of advance refundings of the bonds;

(4) Application of the change-in-use restrictions on the facilities; and

(5) Application of the limitation on the amounts of issuance costs that may be bond financed, the maturity limits on the bond issues, and the public hearing and approval requirements applicable to private activity bonds.

Arbitrage rebate restriction

The bill would create a new exception to the requirement that arbitrage profits on nonpurpose investments be rebated to the Federal Government for governmental bonds (other than tax and revenue anticipation notes) and infrastructure facility bonds. Arbitrage profits on these bonds could be retained by the issuers if prescribed percentages of the gross proceeds of the bond issue were spent before set intervals during the three-year period following issuance. The set intervals and required percentages would be as follows:

(1) 20 percent within one year after issuance;
(2) 50 percent within two years after issuance; and
(3) 95 percent within three years after issuance.

Expenditures for soft costs such as costs of issuance made during the first year following issuance would be included in determining if these requirements were satisfied; however, such expenditures would not be treated as qualifying expenditures if made more than one year after the date the bonds were issued.

b. Capital cost recovery

The bill would assign a seven-year ACRS recovery period, and a 10-year ADR midpoint, to all infrastructure facility property for which a shorter recovery period and ADR midpoint is not currently prescribed. Infrastructure facility property would be defined as property eligible for financing with tax-exempt infrastructure facility bonds (as provided for in the bill, described above).

For infrastructure facility property, the bill also would override the present restriction requiring that the cost of tax-exempt use property be recovered using the decelerated alternative cost recovery system. That restriction as applied to property financed with tax-exempt bonds would be retained.

Effective Dates

The tax-exempt bond provisions of the bill would apply to bonds issued after December 31, 1991.

The capital cost recovery provisions of the bill would apply to property placed in service after December 31, 1991.

Issues

Pros

1. Projects funded using infrastructure facility bonds are sufficiently similar to governmental projects that they should be granted the same tax treatment as governmental projects. Under present law, the projects which are the subject of the infrastructure facility bonds proposal may be financed using private activity bonds. However, the restrictions placed on private activity bonds may, to some extent, hinder the utilization of these bonds since the restrictions impose some burdens (e.g., the requirement to receive a State volume limit allocation) on the issuer which would be removed under the proposal.

2. Governmental construction and infrastructure facility projects may require longer lead times than the two-year construction period implicit in the present-law spend-down requirement for pur-

poses of determining arbitrage rebate payments by issuers of tax-exempt bonds. Accordingly, a longer spend-down period than is provided in present law during which arbitrage profits may be earned by the issuer without being rebated to the Federal Government may be required to ensure that issuers may undertake construction projects without being subject to arbitrage rebate requirements.

3. Many projects that are defined as infrastructure facility bond projects are required by Federal regulations; providing a tax subsidy to these projects is a reasonable response to the need for equitable cost sharing.

4. Infrastructure facility projects tend to be large projects that require large amounts of capital to support them. The State private activity volume limits imposed under present law hamper the ability of State and local governments to finance infrastructure projects along with other projects that benefit private parties.

5. Shorter depreciation lives combined with faster depreciation schedules for property financed by infrastructure bonds would encourage businesses to invest in these projects by increasing the present value of the depreciation deductions available to the taxpayer.

Cons

1. Infrastructure facility bond projects provide subsidized financing for private business capital. The Federal tax subsidy provided to private entities through tax-exempt bonds are generally subject to the requirements imposed on private activity bonds (e.g., State volume limitations, alternative minimum tax preference treatment, etc.). Singling out infrastructure facility projects for more favorable treatment would be inequitable.

2. Infrastructure facility projects are often subsidized through governmental grants (e.g., through various direct spending programs); added Federal tax subsidies may be excessive.

3. Given large Federal budget deficits, Federal tax subsidies should be targeted to benefit those most in need. The infrastructure facility bond program does not consider the social desirability of individual projects eligible for low-cost financing through the use of tax-exempt bonds.

4. The removal of the advance refunding prohibition on infrastructure bonds could result in more than one tax-exempt bond issue being outstanding simultaneously for a single infrastructure project. This results in issuers being able effectively to hedge changes in interest rates with Federally subsidized financing.

5. Removal of the tax-exempt property leasing rules for infrastructure facility projects could result in tax-exempt entities receiving much of the benefit of the Federal subsidy inherent in depreciation. Moreover, prescribing faster depreciation schedules for this property may result in an indirect arbitrage opportunity where governmental entities lease facilities from a taxable entity that can make use of depreciation deductions for tax purposes that far exceed the decline in the economic value of the infrastructure assets.

6. The category of infrastructure is so broad that use of a single ADR life will result in depreciable lives that are totally unrelated to the economic life of the asset.

2. S. 150 (Senators Moynihan, Danforth, Boren, Chafee, Pryor, Daschle, Symms, and Others):

"The Higher Education Tax-Exempt Bond Reform Act of 1991"

Present Law

In general

Present law generally excludes from income interest on State and local government bonds if the bonds are issued to finance direct activities of these governments (sec. 103). Interest on bonds issued by States and local governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is included in the Code. One such exception is for private activity bonds issued to finance activities of charitable organizations described in section 501(c)(3) ("section 501(c)(3) organizations") when the activities do not constitute an unrelated trade or business (sec. 141(e)(1)(G)).

Classification of section 501(c)(3) organization bonds as private activity bonds

Before enactment of the Tax Reform Act of 1986, State and local governments and section 501(c)(3) organizations were defined as "exempt persons," and their bonds generally were subject to the same requirements. As exempt persons, section 501(c)(3) organizations were not treated as "private" persons, and their bonds were not "industrial development bonds" or "private loan bonds" (the predecessor categories to current private activity bonds).

Under present law, a bond is a private activity bond if its proceeds are used in a manner violating either (1) a private business test or (2) a private loan test. The private business test is a two-pronged test. First, the test limits private business use of governmental bonds to no more than 10 percent of the bond proceeds.[2] Second, no more than 10 percent of the debt service on the bonds may be derived from private business users of the proceeds. The private loan test limits to the lesser of five percent or $5 million the amount of governmental bond proceeds that may be used to finance loans to persons other than governmental units.

Special restrictions on tax-exemption for section 501(c)(3) organization bonds

As stated above, present law treats section 501(c)(3) organizations as private persons; thus, bonds for their use may only be issued as

[2] No more than five percent of bond proceeds may be used in a private business use that is unrelated to the governmental purpose of the bond issue. The 10-percent debt service test, described below, likewise is reduced to five percent in the case of such "unrelated and disproportionate" private business use.

private activity "qualified 501(c)(3) bonds," subject to the restrictions of Code section 145. The most significant of these restrictions limits the amount of outstanding bonds from which a section 501(c)(3) organization may benefit to $150 million. In applying this $150 million limit, all section 501(c)(3) organizations under common management or control are treated as a single organization. The limit does not apply to bonds for hospital facilities, defined to include only acute care, primarily inpatient, organizations. A second restriction limits to no more than five percent the amount of the net proceeds of a bond issue that may be used to finance any activities (including all costs of issuing the bonds) other than the exempt purposes of the section 501(c)(3) organization.

The Technical and Miscellaneous Revenue Act of 1988 imposed low-income tenant occupancy requirements on existing residential rental property that is acquired by section 501(c)(3) organizations in tax-exempt bond-financed transactions. Under these requirements, a minimum number of the housing units comprising the property must be continuously occupied by tenants having family incomes of 50 percent (60 percent in certain cases) or less of area median income for periods of up to 15 years. These same low-income tenant occupancy requirements apply to for-profit developers receiving tax-exempt private activity bond financing.

Other restrictions

The Code imposes several restrictions on private activity bonds that generally do not apply to bonds used to finance direct State and local government activities. Many of these restrictions also apply to qualified 501(c)(3) bonds.

(1) No more than two percent of the net proceeds of a bond issue may be used to finance the costs of issuing the bonds, and these amounts are not counted in determining whether the bonds satisfy a requirement that at least 95 percent of the net proceeds of each bond issue be used for the exempt activities qualifying the bonds for tax exemption.

(2) The weighted average maturity of a bond issue may not exceed 120 percent of the average economic life of the property financed with the proceeds.

(3) A public hearing must be held and an elected public official must approve the bonds before they are issued (or the bonds must be approved by voter referendum).

(4) If property financed with private activity bonds is converted to a use not qualifying for tax-exempt financing, certain loan interest penalties are imposed (the "change in use" restrictions).

Both governmental and private activity bonds are subject to numerous other Code restrictions, including the following:

(1) The amount of arbitrage profits that may be earned on investments of tax-exempt bond proceeds is limited, and most such profits on investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government; and

(2) Banks and other financial institutions may not deduct interest they pay to the extent of their investments in most tax-exempt bonds.

Finally, interest on private activity bonds, other than qualified 501(c)(3) bonds, is a preference item in calculating the alternative minimum tax for individuals and corporations.

Explanation of the Bill

Subject to certain exceptions described below, S. 150 would amend the tax-exempt bond provisions of the Code to conform the treatment of section 501(c)(3) organization bonds generally to that provided for bonds issued to finance direct State or local government activities.

Repeal of private activity bond classification for section 501(c)(3) organization bonds

The concept of an "exempt person," that existed under the Code bond provisions before 1986, would be reenacted. An exempt person would be defined as (1) a State or local governmental unit or (2) a section 501(c)(3) organization, when carrying out its exempt activities under section 501(a). Thus, bonds for section 501(c)(3) organizations would no longer be classified as private activity bonds. Financing for unrelated business activities of such organizations would continue to be treated as a private business use for which tax-exempt financing is not authorized.

As exempt persons, section 501(c)(3) organizations would be subject to the same limits as State and local governments on using their bond proceeds to finance private business activities or to make private loans. Thus, no more than 10 percent of the bond proceeds [3] could be used in a business use by a person other than an exempt person if the Code security interest test were satisfied, and no more than five percent ($5 million, if less) could be used to make loans to such "nonexempt" persons.

Repeal of most additional restrictions on section 501(c)(3) organization bonds

Present section 145, which establishes additional restrictions on qualified 501(c)(3) bonds, would be repealed, along with the restriction on bond-financed costs of issuance for section 501(c)(3) organization bonds (sec. 147(h)). This repeal of section 145 would eliminate the $150 million per institution limit on outstanding nonhospital bonds for section 501(c)(3) organizations.

Retention of certain requirements for section 501(c)(3) organization bonds

As stated above, certain special restrictions on bonds for section 501(c)(3) organizations would be retained. First, the bill would retain the requirement that existing residential rental property acquired by a section 501(c)(3) organization in a tax-exempt bond-financed transaction satisfy the same low-income tenant requirements as similar housing financed for for-profit developers. Second, the bill would retain the present-law maturity limitations applicable to bonds for section 501(c)(3) organizations, and the public ap-

[3] This limit would be reduced to five percent in the case of unrelated and disproportionate private business use as under the present-law governmental bond limit on such use.

proval requirements applicable generally to private activity bonds. Third, the bill would continue to apply the penalties on changes in use of tax-exempt bond-financed section 501(c)(3) organization property to a use not qualified for such financing.

Finally, the bill would make no amendments, other than technical conforming amendments, to the present-law arbitrage restrictions, the alternative minimum tax tax-exempt bond preference, or the provisions generally disallowing interest paid by banks and other financial institutions on amounts used to acquire or carry tax-exempt bonds.

Effective Date

Subject to two exceptions, the bill would apply generally to bonds issued after the date of the bill's enactment.

The first exception would exempt bonds issued pursuant to transitional exceptions included in the Tax Reform Act of 1986, unless the issuers elected to be subject to the bill's provisions.

Second, for purposes of the special arbitrage rebate exception for small governmental issuers (a calendar year exception), the bill would apply in calendar years beginning after its enactment.

Issues

Pros

1. The principal beneficiaries of the bill would be private, nonprofit colleges and universities. These institutions provide substantially identical educational services to those provided by governmental higher education institutions. Consistent with the general tax policy goal of providing like treatment for similarly situated persons, the tax-exempt bond rules should recognize this fact and provide comparable access to tax-exempt financing for these entities.

2. In general, private activity tax-exempt bonds are of two types: those used to provide financing for service providers (airports, rental housing developers, charitable organizations) and for service recipients (mortgage revenue bond and student loan bond borrowers). Service-recipient bonds typically are subject to Federal wealth targeting rules like direct Federal spending programs. Service provider bonds on the other hand, generally are targeted by reference to the ultimate beneficiary of the financing, not the service provider. In fact, section 501(c)(3) organizations are the only service-provider beneficiaries of tax-exempt bonds that are subject to wealth targeting (i.e., a limit on outstanding bonds). In the case of service-provider bond beneficiaries, the service provided, not the provider, is the appropriate measure for determining availability of tax-exempt financing.

3. The $150 million per-institution limit on outstanding nonhospital qualified 501(c)(3) tax-exempt bonds was intended as a limit on tax arbitraging of college and university endowments. Other present-law tax-exempt bond restrictions, e.g., the arbitrage rebate requirement and public approval, bond maturity, hedge bond, and advance refunding restrictions, adequately address this concern.

4. The argument that private colleges and universities engage in tax arbitraging of their endowments reflects a misunderstanding of the restrictions governing endowments. Most State laws prohibit depletion of endowment corpus. Further, approximately 65 percent of endowment funds nationally is subject to donor-imposed restrictions on the uses for which even the income may be used.

Cons

1. The present-law tax-exempt bond rules appropriately distinguish between States and local governments and all other permitted beneficiaries of these bonds. Nonprofit colleges and universities are not legally governmental entities or accountable as such. Accordingly, it is appropriate to classify bonds for their benefit as private activity bonds.

2. In the short run, repeal of the $150 million limit would primarily benefit a relatively small number of private, nonprofit universities having endowments among the largest of any in the United States. Such nonprofit institutions with large endowments may use tax-exempt bonds to engage in economic, if not direct tax, arbitrage activities by borrowing at tax-exempt rates instead of spending other available funds. It is appropriate in light of high Federal budget deficits to limit such activities. The $150 million per institution limit on nonhospital qualified 501(c)(3) bonds achieves this objective in a way that is administratively simpler than direct taxes or yield restrictions on these universities' endowment investments.

3. Notwithstanding donor-imposed restrictions on the use of some endowment funds, nonprofit colleges and universities also benefit from substantial amounts of restricted endowment funds available for activities being bond-financed, unrestricted endowment investments, and quasi-endowment funds ("funds functioning as" endowments) which are available for bond-financed activities. Tax-exempt bond financing should not be available to these institutions until such available funds are exhausted.

3. S. 267 (Senators Reid, Bryan, Symms, and Others):

State Taxation of Pension Income of Nonresidents

Present Law

Certain State laws provide that some or all retirement income is included in income for State income tax purposes if the income was earned within the State, even though the individual resides outside the State when the retirement income is actually received. Some States achieve this result through general rules that tax income earned within the State, whereas others have explicit provisions regarding retirement income.

Explanation of the Bill

S. 267 would prohibit any State, including any political subdivision of a State, the District of Columbia, and the possessions of the United States, from imposing income tax on the pension or retirement income of any individual who is not a resident or domiciliary of the State.

Effective Date

The bill would apply to taxable years beginning after December 31, 1991.

Issues

Pros

1. The bill would eliminate what may be perceived as an unfair imposition of State tax on individuals who have little current contact with the State.
2. If a large number of States were to tax pension benefits earned in the State when received, then a retiree who worked in several different States would have complex State income tax filing responsibilities.

Cons

1. The bill will likely be viewed by States with income tax laws as an unwarranted intrusion on their ability to tax income derived from the State and an unjustified erosion of their tax base. Some States enacted laws taxing nonresident retirement income to prevent avoidance of State tax. For example, in the absence of such laws, individuals can avoid State taxation of income by structuring compensation agreements to characterize what otherwise would be current compensation as pension income. The proposal would make it more difficult for States to prevent such abuses.

2. The ability of the Federal Government to enforce the bill is unclear. While the Constitution gives the Federal Government some authority to regulate State tax laws in particular circumstances, it is unclear whether that authority would extend to this bill.

4. S. 284 (Senators Bradley, Symms, Grassley, Chafee, Danforth, Baucus, Breaux, Packwood, Roth, and Others):

Treatment of Payments Under Life Insurance Contracts for Terminally Ill Individuals

Present Law

In general

The undistributed investment income ("inside buildup") earned on premiums credited under a contract that satisfies a statutory definition of life insurance is not includible in the gross income of the owner of the contract. In addition, death benefits paid under a contract that satisfies the statutory definition are excluded from the gross income of the recipient, so that neither the owner of the contract nor the beneficiary of the contract is ever taxed on the inside buildup if the proceeds are paid to the beneficiary by reason of the death of the insured. Amounts received under a life insurance contract (other than a modified endowment contract) prior to the death of the insured are includible in the gross income of the recipient to the extent that the amount received exceeds the recipient's investment in the contract (generally, the aggregate amount of premiums paid less amounts previously received that were excluded from gross income).

Definition of a life insurance contract

In order to qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test, or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement. A contract satisfies the cash value accumulation test if the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium/cash value corridor test if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

The net single premium for purposes of the cash value accumulation test and the guideline single premium or guideline level premiums for purposes of the guideline premium/cash value corridor test are the amounts necessary to fund the future benefits under the contract. For this purpose, the term "future benefits" means death benefits and endowment benefits. In addition, the charge stated in a contract for any qualified additional benefit is treated

as a future benefit, thereby increasing the applicable limitation by the discounted value of the charge. The term "qualified additional benefit" means guaranteed insurability, accidental death or disability, family term coverage, disability waiver, and any other benefit prescribed under Treasury regulations.

Explanation of the Bill

S. 284 would provide an exclusion from gross income for amounts received by an individual under a life insurance contract if the insured under the contract is terminally ill. For this purpose, an individual would be considered terminally ill if the individual has been certified by a licensed physician as having an illness or physical condition that can reasonably be expected to result in death in 12 months or less.

In addition, in determining whether a contract qualifies as a life insurance contract for Federal income tax purposes, the bill would treat a qualified terminal illness rider (i.e., a provision in the contract that provides for the payment of a benefit to an individual upon the insured becoming terminally ill) as a qualified additional benefit. Consequently, the applicable limitations for purposes of the definition of a life insurance contract would be increased by the discounted value of the charge for the qualified terminal illness rider.

Under the bill, the addition of a qualified terminal illness rider to a contract would not be treated as a modification of, or a material change to, the contract for purposes of the definition of a life insurance contract and the definition of a modified endowment contract. Further, for purposes of the rules that apply to life insurance companies, a qualified terminal illness rider would be treated as life insurance.

Finally, under the bill, applicants for, and recipients of, benefits under certain public assistance programs (for example, Medicaid) would not be required to take into account the right to receive an accelerated death benefit in determining eligibility for the public assistance benefits. For this purpose, an accelerated death benefit would be defined as any payment made under a life insurance contract while the insured is alive as a result of a recalculation of the life expectancy of the insured.

Effective Dates

The provision of the bill that provides an exclusion from gross income for certain amounts received under a life insurance contract would apply to taxable years beginning after December 31, 1989. The other Federal income tax provisions of the bill would apply to taxable years beginning before, on, or after December 31, 1989. The provision of the bill that relates to public assistance benefits would be effective on January 1, 1990.

Issues

Pros

1. The bill would ease the financial burden of many terminally ill individuals and their families by not imposing Federal income tax on benefits received under life insurance contracts prior to death. The amount of Federal income tax that would otherwise be paid could be used to pay the medical bills and other living expenses of the terminally ill individual.

2. The bill may reduce the amount that would otherwise be paid under Federal or State public assistance programs (such as Medicaid) by encouraging terminally ill individuals to elect to accelerate the receipt of death benefit payments.

3. Certain noninsurance companies currently purchase life insurance contracts from terminally ill policyholders. These companies may not pay policyholders the present value of the death benefit under the contract. The bill would encourage policyholders to elect to accelerate the death benefit payment from the issuing insurance company, which is subject to State regulation and, therefore, is more likely to pay the policyholder the present value of the death benefit under the contract.

Cons

1. The bill would result in the unequal treatment of terminally ill individuals because it would provide a tax benefit only for those who own life insurance at the time of their terminal illness. In addition, the bill would primarily benefit higher-income individuals who are able to afford greater amounts of life insurance. A more efficient and equitable tax subsidy could be developed if the goal is to assist the terminally ill.

2. The treatment of inside buildup under present law favors life insurance as an investment over other investment vehicles thereby distorting the flow of savings and investment in the economy. The bill would provide an additional incentive for individuals to purchase life insurance and would exacerbate the inefficiencies of present law.

3. If the purpose of the bill is to encourage individuals to purchase insurance that covers the expenses of a terminal illness, the bill is inefficient because it requires the purchase of life insurance in order to obtain the favorable tax treatment. A more efficient approach would be to provide a tax subsidy for the purchase of terminal illness insurance.

4. The certification requirement contained in the bill may be difficult to administer and may result in the receipt of tax-free benefits in certain cases where the insured is not reasonably expected to die within 12 months. The life insurance company may be indifferent to the payment of benefits where the insured is not reasonably expected to die within 12 months if the amount paid is discounted sufficiently to compensate the insurance company for the early payment of the benefit.

5. S. 649 (Senators Breaux, Chafee, Pell, and Others):

Repeal of the Luxury Excise Tax on Boats and Yachts

Present Law

General rules

Present law imposes a 10-percent excise tax on the portion of the retail price of boats and yachts that exceeds $100,000.

Boats and yachts that are used exclusively (other than a de minimis amount) in a trade or business (except for entertainment or recreation purposes, including the trade or business of providing entertainment or recreation) are exempt from this tax. In addition, boats and yachts that are used exclusively in the trade or business of commercial fishing or of transporting persons or property for compensation or hire are exempt from this tax. The transporting of persons or property for compensation or hire includes transportation by a cruise ship (regardless of destination) or by a boat chartered with a pilot. These may be exempt from the tax provided that the other conditions for exemption are met.

In addition, present law imposes a 10-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified:

(1) *Automobiles above $30,000.*—The tax applies to passenger automobiles, which includes trucks and vans with a loaded gross vehicle weight of 6,000 pounds or less. Limousines are subject to this tax regardless of weight. The tax does not apply to the sale or leasing of any passenger vehicle for use by the purchaser or lessee exclusively (other than a de minimis amount) in the active conduct of a trade or business of transporting persons or property for compensation or hire.

(2) *Aircraft above $250,000.*—The tax applies to aircraft above $250,000, with exceptions for aircraft 80 percent of the use of which is in a trade or business, and certain other uses.

(3) *Jewelry above $10,000.*—The tax applies on an item-by-item basis. Custom fabrication of jewelry (from new or used materials) also is subject to this tax. Repairs and slight modifications to jewelry are not subject to this tax.

(4) *Furs above $10,000.*—The tax applies to items made from fur or in which fur is a major component. The tax does not apply to leather or to artificial fur.

Special rules

Tax applicable only to newly manufactured items.—The tax applies only to the first retail sale (for a purpose other than resale) after manufacture, production or importation of items subject to the tax. It does not apply to subsequent sales of these items. Thus, for example, if a boat dealer sells a new boat for $150,000, that

item is subject to this tax. If, however, the boat dealer sells a used boat for $150,000, that sale is not subject to this tax.

If a sale is voided, the tax is refunded. Thus, for example, if a taxpayer purchases a boat subject to the tax and pays the tax, but later returns the boat to the dealer for a refund of the purchase price, the tax would also be refunded at that time.

Collection and deposit of tax.—In general, the retailer must collect the tax and remit it to the IRS in accordance with the rules generally applicable to excise taxes.

Anti-abuse rules.—An anti-abuse rule prevents businesses from briefly using boats subject to tax in their trade or business and then selling them (or converting them to personal use) a short time thereafter as a way of avoiding tax. An additional rule prevents the avoidance of the tax on boats and yachts through separate purchases of major component parts. Thus, for example, if the taxpayer purchases a sailboat from a distant boatyard without an inboard motor or mast, and purchases and has installed locally the inboard motor and mast, those purchases would be aggregated for purposes of this tax. The installer must collect the tax due and remit it to the IRS.

Special rule for leases.—A special rule applies to the leasing of boats and yachts by a person in the trade or business of leasing. These lessors do not pay the tax on their purchase of these items; instead, their leasing of these items is treated as a sale. Thus, a pro rata portion of the tax is due on each lease payment, unless the lease payment is being made by a person who would be exempt from the tax (because of the nature of the use of the item) if the person owned the item.

Exemptions.—In addition to the other exemptions from this tax, the tax does not apply to boats used exclusively by the Federal Government or a State or local government for public works purposes. Thus, a State ferry boat would not be subject to the tax. The use must be directly and integrally related to the public works purpose.

Determination of price.—The retail sales price is the price paid by the retail customer, including any charge incident to placing the article in condition ready for use (such as preparation charges, dealer add-ons, and delivery charges). Retail sales taxes (if separately stated) are excluded. The retail sales price is determined without subtraction for any trade in. Thus, the total price paid (whether paid in cash, in a trade in, or otherwise) is the retail sale price. The manufacturer's suggested retail price (if any) is not the basis on which the price is computed. Significant variation from general retail market prices of comparable items may, however, be considered by IRS to be an indication of an attempt to avoid the tax. Rebates that are fixed at the time of sale and that go directly to the customer reduce the sales price for purposes of computing this tax.

Tax applicable to imports.—This tax applies to all boats and yachts subject to the tax upon their importation into the United States (regardless of whether the boat or yacht was used outside the United States prior to importation), unless the item is being imported by someone in the trade or business for subsequent retail sale or leasing (in which instance the subsequent retail sale or

lease would be subject to tax). Thus, for example, the tax is imposed on the retail value of a boat (whether new or used) that an individual imports for personal use. The tax does not apply to any use of a boat or yacht after import if the user establishes to the satisfaction of the Secretary that the first sale or use occurred outside the United States prior to January 1, 1991.

Tax inapplicable to exports.—This tax does not apply to exported boats and yachts.

Effective date of tax.

The luxury excise tax on boats and yachts and the other luxury excise taxes were enacted as part of the Omnibus Budget Reconciliation Act of 1990, which included increases in the rates of several existing excise taxes. The tax on boats and yachts applies after December 31, 1990, and before January 1, 2000. The tax does not apply to a boat or yacht purchased pursuant to a contract that was binding on the purchaser on September 30, 1990, and at all times thereafter and before January 1, 1991.

Explanation of the Bill

S. 649 would repeal the luxury excise tax applicable to boats and yachts.

Effective Date

The bill would be effective as if included in the Omnibus Budget Reconciliation Act of 1990 (retroactive to January 1, 1991).

Issues

Pros

1. The luxury excise tax on boats and yachts may be difficult and potentially costly to administer relative to the revenue raised from the tax.
2. The luxury excise tax on boats and yachts may reduce the demand for boats and yachts costing in excess of $100,000, which may lead to a reduction in employment in the boat and yacht industry.

Cons

1. By imposing luxury excise taxes upon many of the luxury items that higher income persons might purchase, the burden of these taxes is more likely to fall on the higher income individual. This increases the progressivity of the overall Federal tax system.
2. The demand for luxury goods may be relatively price insensitive, in which case the demand for luxury goods and employment in those industries is more likely to be determined by general economic conditions than by taxes imposed upon such goods.
3. Taxes on consumption generally discourage consumption and promote saving, which is important to future economic growth.
4. Repeal of the luxury excise tax on boats and yachts would increase the comparative advantage of boats and yachts over several other taxed luxury goods.

5. The luxury excise taxes were included in the Omnibus Budget Reconciliation Act of 1990 as a partial offset for the perceived regressivity of increases in other excise taxes (e.g., motor fuels, alcohol, tobacco). Repealing the luxury excise tax on boats and yachts may be viewed as counter to the 1990 budget agreement.

6. S. 913 (Senators Baucus, Dodd, Boren, and Riegle): "The Tax-Exempt Bond Simplification Act of 1991"

Present Law

In general

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (sec. 103). Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties, if the financed activities are specified in the Code. Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Private activity bonds are bonds (1) more than 10 percent of the proceeds of which satisfy a private business use and payment test, or (2) more than five percent ($5 million, if less) of the proceeds are used to finance loans to persons other than State or local governmental units. A special restriction limits to no more than five percent the amount of bond proceeds that may be used in a private business use that is unrelated to direct governmental activities also being financed with a bond issue. This five-percent restriction is known as the "unrelated and disproportionate private business use limit."

Interest on the following private activity bonds qualifies for exclusion:

(1) Exempt-facility bonds;
(2) Qualified mortgage and qualified veterans' mortgage bonds;
(3) Qualified small-issue bonds;
(4) Qualified student loan bonds;
(5) Qualified redevelopment bonds; and
(6) Qualified 501(c)(3) bonds.

Exempt-facility bonds are bonds the proceeds of which are used to finance the following: airports, docks and wharves, mass commuting facilities or high-speed intercity rail facilities; water, sewage, solid waste, or hazardous waste disposal facilities; facilities for the local furnishing of electricity or gas; local district heating or cooling facilities; and certain low-income rental housing projects.

Arbitrage restrictions

Issuers of all tax-exempt bonds generally are subject to two sets of restrictions on investment of their bond proceeds. As explained more fully below, the two sets of restrictions generally apply with respect to different time periods following issuance of the bonds.

Yield restriction requirement

In general, tax-exempt bond proceeds may not be invested at a yield materially higher than the bond yield, i.e., only limited arbitrage profits may be earned. Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds (generally prescribed in Treasury Department regulations). Additional exceptions are provided for bond proceeds invested as part of a reasonably required reserve or replacement fund and for a "minor" portion of the issue proceeds, both throughout the term of the issue.

Unlike the rebate requirement described below, the yield restriction requirement applies both to investments unrelated to the purpose of the borrowing ("nonpurpose investments") and to investments such as a loan to the ultimate borrower of the bond proceeds in the case of private activity bonds ("purpose investments").

Rebate requirement

Generally, all arbitrage profits earned on nonpurpose investments of bond proceeds during periods when such earnings are permitted (e.g., temporary periods) must be rebated to the Federal Government. Permitted arbitrage profits on purpose investments (limited by the yield restriction requirement described above) are not subject to the rebate requirement. Present law includes three principal exceptions to the rebate requirement on nonpurpose arbitrage profits.

Six-month expenditure exception.—First, if all gross proceeds of an issue are spent for the purpose of the borrowing within six months after the bonds are issued, no rebate is required. This exception may be satisfied notwithstanding the presence of a reasonably required reserve or replacement fund if all proceeds other than those invested as part of the reserve fund are so spent and arbitrage profits on the reserve fund (and any bona fide debt service fund subject to rebate) are rebated.

24-month construction bond expenditure exception.—Second, no rebate is required for certain construction bond issues if the available construction proceeds are spent for the purpose of the borrowing at least at specified rates during the 24-month period after the bonds are issued. A construction bond issue is an issue at least 75 percent of the net proceeds of which are to be used to finance construction (as opposed to acquisition) expenses. Construction bonds eligible for this exception include all governmental bonds, qualified 501(c)(3) bonds, and private activity bonds the proceeds of which are used to finance property owned by a governmental unit.

The minimum spending rates are as follows: (1) at least 10 percent spent within six months after the bonds are issued, (2) at least 45 percent spent within 12 months, (3) at least 75 percent spent within 18 months, and (4) 100 percent spent within 24 months. Amounts of reasonable retainage (not exceeding five percent of the available construction proceeds) that remain unspent after 24 months, and which are spent no later than 36 months after issuance do not preclude eligibility for this exception.

Issuers of construction bonds with respect to which these spending requirements are not satisfied may elect to pay a special penal-

ty equal to 1.5 percent of shortfall in spending at each six-month interval in lieu of complying with the general rebate requirement. Additionally, these issuers may elect to terminate these 1.5-percent penalties by payment of an additional 3-percent penalty on the earlier of (1) expiration of the initial temporary period when proceeds may be invested without regard to yield or (2) substantial completion of the spending purposes of the borrowing.

The construction bond exception applies to bonds issued after December 19, 1989.

Small-issuer exception.—Bonds other than private activity bonds issued by governmental units having general taxing powers are not subject to the rebate requirement if the governmental unit (and all of its subordinate units) issues $5 million or less in such governmental bonds during a calendar year.

Restrictions on advance refundings

The Code restricts authority to advance refund tax-exempt bonds to bonds other than private activity bonds and to private activity qualified 501(c)(3) bonds. An advance refunding is a refunding where the refunded bonds are not redeemed within 90 days after the refunding bonds are issued. Except for certain bonds originally issued before 1986, each issue of new money governmental and qualified 501(c)(3) bonds may be advance refunded only one time.

In addition, the Code prohibits the advance refunding of any bond if the transaction involves the use of a "device" to obtain a material financial advantage (based on arbitrage) other than the savings received from lower interest rates on the refunding bonds. The Treasury Department is authorized to identify prohibited devices by regulation.

Tax treatment of financial institutions investing in tax-exempt bonds

Banks and other financial institutions generally are denied a deduction for the portion of their interest expense (e.g., interest paid to depositors) that is attributable to investments in tax-exempt bonds acquired after August 7, 1986. This disallowance is computed using a prorata formula that compares the institution's average adjusted basis in tax-exempt bonds acquired after that date with the average adjusted basis of all assets of the institution.

An exception to this prorata disallowance rule is permitted for governmental bonds and qualified 501(c)(3) bonds issued by or on behalf of governmental units that issue no more than $10 million of such bonds during a calendar year.

Explanation of the Bill

S. 913 would make numerous changes to requirements governing issuance of tax-exempt bonds.

Unrelated and disproportionate private business use limit

The bill would repeal the unrelated and disproportionate private business use limit, effective for bonds issued after the date of the bill's enactment. Allowable private business use of governmental bond proceeds would continue to be restricted by the general pri-

vate business use and payments test and the private loan bond restriction.

Liberalization of arbitrage restrictions

Elimination of yield restriction requirement in certain cases

The bill would eliminate the present-law arbitrage yield restrictions for all bonds other than advance refunding bonds except where the Treasury Department by regulation identified the yield restriction requirement as existing for a purpose other than preventing the earning of arbitrage profits. This provision would apply to bonds issued after the effective dates of the bond provisions in the Tax Reform Act of 1986, but only with respect to earnings accruing after the date of the bill's enactment.

Reduction of arbitrage profits subject to rebate

The bill would permit issuers to retain 10 percent of the arbitrage profits they earn on nonpurpose investments, effective for bonds issued after the date of the bill's enactment.

Expansion of small-issuer rebate exception

The bill would increase the $5 million annual issuance limit for small issuers whose governmental bonds are not subject to rebate to $25 million, and would expand the exception to apply to governmental bonds issued (1) by governmental units without taxing powers and (2) by "on behalf of" authorities that are not themselves governmental units.

This provision would be effective for bonds issued after December 31, 1990.

Retroactive relief for certain construction bond issues

The bill would make retroactive the present 24-month expenditure exception to the arbitrage rebate requirement for certain construction bonds. Thus, issuers of such bonds issued after August 15, 1986 (August 31, 1986 for governmental bonds) would be exempt from rebate on a prospective basis if they satisfied the 24-month expenditure schedule. Additionally, issuers of bonds issued after those dates could elect to comply with the exception's penalty regime on unexpended proceeds in lieu of further rebate.

Identification of prohibited device

The bill would treat as a prohibited device the issuance of advance refunding bonds in conjunction with the investment of existing bond funds (released from bond indenture restrictions) in investment contracts having materially higher and substantially guaranteed yields, if such an investment occurred within 90 days before or after issuance of advance refunding bonds.

This provision would apply to advance refunding bonds issued after February 26, 1990.

Expansion of financial institution small-issuer exception

The bill would increase from $10 million to $25 million the small-issuer exception to the interest expense deduction prorata disallow-

ance rule applicable to banks and other financial institutions, effective for bonds issued after December 31, 1990.

Issues

Pros

1. Whether a private business use is "related" to a governmental activity also being financed with a bond issue is a complex facts and circumstances determination. In light of the general 10-percent limit on private business use, the private loan restriction, and the State volume limit requirement for larger governmental bond issues, the complexity associated with this determination outweighs any marginal benefit (maximum of $7.5 million per issue) derived by limiting tax-exempt financing for unapproved private activities.

2. The arbitrage rebate and yield restriction requirements serve the same policy objective—elimination of earlier and larger than necessary issuance of tax-exempt bonds. The ability to earn—but not retain—arbitrage profits does not create an incentive to violate this Federal policy.

3. Requiring issuers of tax-exempt bonds to rebate all arbitrage profits to the Federal Government encourages investments that nominally produce no such profit, but may in fact, represent creation of an indirect profit for suppliers of investment vehicles such as guaranteed investment contracts. Such an indirect profit is prohibited under present law as a deflection of arbitrage, but factually the activity is difficult to police. Repealing the yield restriction requirement could reduce the incentive to engage in this "yield burning" investment activity. Further allowing these issuers to retain a portion of any profit earned will encourage more efficient investment, with the Federal Government sharing the benefit of these investments.

4. The exception from the arbitrage rebate requirement for bonds of smaller governmental units reflects a balancing of the policy of preventing arbitrage-motivated bond issuance and the administrative responsibilities necessary to comply. Increasing the current $5 million annual issuance limit defining eligible governments may be appropriate if administrative complexity is shown to outweigh the threat of potential arbitrage-motivated issuance.

5. The 24-month construction bond exception applies to bonds issued after December 19, 1989. Making this exception retroactive to the effective dates of the Tax Reform Act of 1986 will relieve additional issuers of the administrative complexities associated with rebate, while not encouraging issuance of additional bonds.

6. Bonds of smaller governmental units are exempt from general restrictions on banks and other financial institutions deducting costs of acquiring and carrying tax-exempt investments because the small size of their bond issues may render other markets unavailable. Increasing the current $10 million annual issuance limit for eligible governments may be appropriate if non-financial institution markets are demonstrated to be unavailable for bonds of the additional issuers.

Cons

1. The five-percent unrelated and disproportionate private business use limit is the effective limit on private business use for many tax-exempt bonds. Repealing this limit will increase the private activities for which tax-exempt financing may be provided outside of restrictions (e.g., State volume limits) generally applicable to such private, conduit financing without ensuring the Congressional review generally accompanying the allowance of this Federal subsidy.

2. Issuers of tax-exempt bonds have been subject to yield restriction requirements since 1969, with rebate having been required for all bonds only since 1986. Except for reasonably required reserve funds, the rebate and yield restriction requirements generally apply to different time periods. An administratively simpler approach to the problem of duplicative requirements might be to limit the rebate requirement to prescribed temporary periods and to reserve funds because issuers have been accustomed to complying with the yield restriction requirement for over 20 years.

3. While allowing issuers to retain a portion of arbitrage profits may discourage yield-burning transactions, it also could lead to earlier and larger issuance of tax-exempt bonds—at an increased Federal revenue cost—if issuers attempted to maximize the arbitrage profits they could retain. This would be particularly true if the present-law yield restriction requirement also were repealed, thereby allowing issuers to earn profits and to retain a percentage of them over extended periods.

4. The small-issuer arbitrage rebate exception is intended to relieve the smallest governmental units from the administrative complexity of compliance with that requirement because they may lack in-house accounting personnel and is premised in part, on the limited incentives for arbitrage-motivated transactions with smaller bond issues. Increasing the annual issuance limit on this exception to $25 million is inconsistent with these objectives because of (1) greater availability of in-house accounting staff to these larger issuers, (2) ready access to computer programs for performing rebate calculations, and (3) greater incentive for arbitrage-motivated transactions due to larger dollar volumes of eligible bonds.

5. Issuers of bonds issued before December 20, 1989, are unlikely to have complied with the spending requirements of the 24-month construction bond exception to the rebate requirement because the rule did not exist when their bonds were issued. Retroactive application of this provision, therefore, merely creates a financial planning opportunity in that the issuers will choose to terminate their current rebate liability in cases where substitution of the 1.5-percent penalty regime of the 24-month exception is more financially advantageous to them.

6. The growth since 1986 of individual investors in tax-exempt bonds, primarily through investment in mutual funds, has eliminated the marketing difficulties historically addressed by bank and

million per issuer provides an unnecessary tax subsidy to these financial institutions.
financial institution purchases. In light of these market changes, allowing banks an exception from the prohibition on deducting interest incurred to acquire or carry tax-exempt bonds of up to $25

[SUBMITTED BY SENATOR JOHN BREAUX]

STATEMENT OF ROBERT M. MCELWAINE, EXECUTIVE DIRECTOR, FEDERATION AGAINST INEQUITABLE AND REGRESSIVE TAXATION (FAIRTAX)

Mr. Chairman and Members of the Subcommittee: On behalf of the Federation Against Inequitable and Regressive Taxation (FAIRTAX), we file this statement in support of S. 649 to repeal the 10% retail excise tax on boats. FAIRTAX is comprised of dealers of BMW, Ferrari, Jaguar, Mercedes-Benz, Porsche, and Rolls-Royce automobiles.

We believe the boating industry has made a compelling case for repeal of the inaptly named "luxury tax". The legislation has failed miserably in achieving its apparently intended goal of "soaking the rich." All it has done is hurt small businesses and working men and women and their families across the country. Moreover, the evidence continues to mount that the tax ultimately will result in net revenue losses. As the American Institute of Certified Public Accountants recently said in formal comments to the Internal Revenue Service: "It appears that the revenues to be produced by this tax will be far outweighed by the costs of administration, collection and compliance by the government and taxpayers." In short, the "luxury tax" has proved to be a dramatic example of the law of unintended consequences.

We therefore urge you to join with your colleagues in supporting legislation to repeal the "luxury tax" before it inflicts any more damage on the economy, hurts any more families, or causes any further increase in the federal deficit or state treasury losses.

To help you appreciate the impact the tax is having on the automobile sector, we have included with our statement a recent independent study prepared by Temple, Barker & Sloane, Inc., a general management consulting and market research firm with two decades of experience in the automobile and transportation sectors. The Temple, Barker & Sloane study concluded:

- The tax has caused at least a *20 percent permanent drop in demand* for vehicles priced over $30,000, with the burden falling most heavily on European makes;
- A 20 percent decline represents at least *$1.3 billion in lost sales* for high-line dealerships in 1991 alone;
- *At least 3,320 employees* in these dealerships *will lose their jobs* as dealerships close across the country and as others cut back on the number of employees they can keep gainfully employed; and
- The *federal government and state governments will lose at least $135.5 million in 1991* just as a result of the impact of the tax on high-line automobile dealerships. These losses include lost customs duties ($22.5 million), lost federal income tax revenues ($26.0 million), lost gas guzzler tax revenues ($22.5 million), and lost state sales tax revenues ($64.5 million). These estimates are clearly conservative because they do not include other costs to the federal government, such as the cost of enforcing the tax or paying unemployment benefits to workers who lose their jobs.

The study documents what dealers know only too well: The American public is refusing to be saddled with another tax. They have stopped buying cars, boats, small airplanes, jewelry, and furs. We believe it is essential for Congress to repeal this terrible tax before more Americans are hurt and the budget deficit grows any

larger. As one of your colleagues so aptly said on the floor last week, "this tax is a luxury that American's economy and workers cannot afford".

We offer three additional reasons for you to repeal the tax this year. First, its existence has led a number of state legislatures to consider imposing additional state "luxury taxes." To date, legislation has been introduced in California, Connecticut, Kansas, Minnesota, and Nevada, but fortunately not one of these bills has been enacted into law. As long as the federal law remains on the books, however, state legislatures will continue to make the unfortunate assumption that this form of taxation raises revenue painlessly. In fact, the imposition of state taxes on top of the federal tax could be the final crippling blow to many retailers and their employees. It is essential for Congress to signal to the states that "luxury taxes" don't work as advertised.

Second, the legislation violates U.S. obligations under Articles I and III of the General Agreement of Tariffs and Trade. Although structured as a trade-neutral revenue measure applicable to both imported and domestic vehicles, the tax burden falls primarily on imports, principally European-made vehicles. Whether it intended to or not, Congress discriminated against European-made cars and put them at a competitive disadvantage in the U.S. market. The European Commission already has signalled its concern about the legislation in its annual Report on United States Trade Barriers and Unfair Practices (1991). Press reports indicate the European Commission is now weighing a formal GATT challenge that, if successful, could lead to restrictions on U.S. exports to the Community. At this crucial stage of the GATT Uruguay Round multilateral trade talks, with the Finance Committee having overwhelmingly supported continued "fast track" negotiations, we think it important for the Subcommittee to support repeal legislation.

Finally, by acting quickly as the Australian federal government has done, our government can eliminate a significant drain on the federal treasury. In January 1990, the Australian federal government had enacted a new "luxury tax" on automobiles with the hope of raising approximately $A109 million in additional revenue. After one year of operation, however, the law had led to revenue losses projected to reach $A260 million annually. Faced with widespread job losses, dealership closings, and mounting revenue shortfalls, on March 12, 1991 the Australian federal government rescinded the legislation.

Given the harm this terrible tax has caused here in the United States, we urge you to help our colleagues in the boating industry and in all the other affected industries by enacting repeal legislation this year.

Thank you.

Economic Effects of the Automobile Luxury Tax

Prepared for

Federation Against Inequitable and Regressive Taxation (FAIRTAX)

Prepared by

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Executive Summary

Effect of the Luxury Tax on Demand for High-Line Cars

The luxury tax on automobiles, effective January 1, 1991, has created a permanent drop in demand of at least 20 percent for vehicles priced over $30,000. This decline in demand, exhibited by the severe decrease in sales during the first quarter of 1991, underscores the price sensitivity of potential luxury car buyers. The burden of the tax has fallen most heavily on European makes.

A 20 percent decline represents lost sales of 24,316 vehicles during 1991 alone and approximately $1.31 billion in lost sales for high-line dealerships.

Net Employment Effect of the Luxury Tax

The significant decrease in sales caused by imposition of the luxury tax will directly affect dealerships and their employees by forcing dealerships already in precarious financial positions out of business and by compelling surviving dealerships to lay off employees. Further, other businesses related to the importing of luxury cars will be adversely affected. The net employment effect of the luxury tax will be a loss of at least 3,320 jobs, or 8 percent of total high-line dealership employment.

Source	Number of Jobs Lost
Non-Surviving Dealerships	2,150
Surviving Dealerships	1,125
Secondary Employment	45
Total	3,320

In addition, as sales fall, dealerships will continue to lay off additional personnel such as service technicians and clerical workers. Because our employment figures do not include these additional job losses, our projection of dealership employment effects should be considered conservative.

Total Cost of the Luxury Tax to Federal and State Governments

The luxury tax will cost the federal and state governments at least $135.5 million in 1991. These costs come from reductions in federal customs duty revenues, gas guzzler tax revenues, and state sales tax revenues caused by lost sales. In addition, federal income tax revenues will suffer from a dramatic increase in the number of unprofitable dealerships in 1991.

Source	1991 Lost Government Revenues
Lost Customs Duties	$22.5 million
Lost Federal Income Tax Revenues	$26.0 million
Lost Gas Guzzler Tax Revenues	$22.5 million
Lost State Sales Tax Revenues	$64.5 million
Total Cost of Luxury Tax	$135.5 million

We have not attempted to estimate other costs to the federal government, such as the cost of enforcing the tax or paying unemployment benefits to workers who lose their jobs as a result of the decline in sales. Thus, our estimates of lost revenue also appear to be conservative.

Introduction

Purpose of the Study

As of January 1, 1991, Congress has imposed a "luxury" tax of 10 percent on automobiles priced over $30,000. The purpose of this study is to explore the magnitude of costs associated with the luxury tax.

Research and Analysis

Whenever possible, data necessary for the research and analysis have been obtained from publicly available sources such as *Ward's Automotive Reports* and the National Automobile Dealers Association. Calculations have been based on conservative assumptions and are easily duplicated.

Sponsor of the Study

The study was sponsored by the Federation Against Inequitable and Regressive Taxation (FAIRTAX), a coalition of BMW, Ferrari, Jaguar, Mercedes-Benz, Porsche, and Rolls-Royce dealers and importers.

Consultant for the Study

The study was conducted for FAIRTAX by Temple, Barker & Sloane, Inc. (TBS), a general management consulting and market research firm. The 500 members of TBS's professional staff offer management and economic counsel to a broad range of commercial and government clients. TBS has assisted many organizations in the automotive and transportation sectors in solving a variety of management problems. The study was prepared under the direction of John B. Schnapp, Vice President and head of the automotive practice at TBS.

Although several members of the FAIRTAX coalition contributed data for this study, neither these firms nor the sponsor of the study attempted to influence TBS's findings or conclusions.

Chapter 1
Effect of the Luxury Tax on Demand for High-Line Cars

Assessing Price Sensitivity of Buyers of High-Line Cars

TBS explored the effect of the luxury tax on demand for high-line cars, the majority of which carry manufacturer suggested retail prices (MSRPs) in the $40,000–50,000 range, by analyzing records of buyer behavior in three instances:

- Historic experience with sudden price increases in the high-line automobile market
- Buyer reaction to knowledge of the impending application of the tax
- Buyer behavior since the tax has been imposed

We have concluded that buyers of typical high-line cars are sensitive to the $1,000 to $2,000 additional expense caused by the tax, and that demand for automobiles in this category has dropped permanently since the tax has been in effect.

Historical Analogy: The Mercedes-Benz 300E, 1986 through 1990

For the past five years, the best-selling high-line vehicle series has been the Mercedes-Benz 300E. In 1987 and again in 1988, its price was increased by more than 5 percent. The price-sales pattern that emerged is shown below.

Price-Sales Pattern of Mercedes-Benz 300E

	1986	1987	1988	1989	1990
Price (in thousands of dollars)	$36.7	$41.1	$43.4	$44.9	$46.0
Increase over prior year	N/A	11.8%	5.6%	3.4%	2.5%
Sales (in thousands)	23.6	16.4	15.7	18.6	16.9
Increase or decrease from prior year	N/A	(30.5%)	(4.3%)	18.5%	(9.1%)

Source: *Ward's Automotive Reports;* New Car Cost Guide.
N/A = Not applicable.

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Two observations stand out in tracing this history:

- Significant price increases were accompanied by significant declines in demand.
- Despite relative price stability in 1989 and 1990, sales did not return to the level they had reached prior to the increase instituted in 1987.

To place this "case history" in perspective, the increase encountered by a prospective buyer of this particular vehicle in 1991 would comprise $1,250 in MSRP plus $1,720 from the luxury tax, for a total of $2,970, or 6.5 percent, above the 1990 price.

Buyer Anticipation of the Luxury Tax: The December 1990 Buying Rush

Over the course of the first 11 months of 1990, sales of high-line cars were less affected by the general downturn in demand than were sales of all passenger cars. It is a conservative assumption that without the onset of the luxury tax, sales in December would have maintained the same correlation to overall passenger car sales that existed during the previous 11 months. Under this assumption, combined sales of BMW, Jaguar, Mercedes, and Porsche models soon to be subject to the tax would amount to approximately 11,500 units in December. However, 15,567 units were actually sold in that month, more than 35 percent above the figure that would have been expected without the tax. (See Appendix A.)

Changes in Sales from Previous Year: High-Line and All Passenger Cars

	High-Line	All Passenger Cars
January-November 1990	(1.0%)	(5.3%)
December 1990	43.9%	1.6%

Source: *Ward's Automotive Reports.*

TBS has concluded that the magnitude of this sales abnormality indicates that the prospect of the luxury tax led large numbers of prospective buyers of high-line cars to purchase these cars earlier than they would have otherwise.

Buyer Behavior Under the Tax: 20 Percent Decline in Demand

After analyzing passenger car sales data, TBS has concluded that the luxury tax has resulted in a permanent drop in demand of at least 20 percent for high-line cars. Our analysis factors out the effects of both the high-line buying rush that led to inflated sales figures in December 1990 and the overall decline in passenger car sales in the first quarter of 1991, which resulted from the war and recession. The methodology TBS used to isolate the luxury tax from the other factors affecting demand is detailed in Appendix A.

The chart below summarizes our findings.

Effects of the Luxury Tax on Sales of High-Line Vehicles*

	"Normal" Sales	Actual Sales	Units Accounted for by Buying Rush	Units Attributed to Permanent Demand Decline	Percentage of Sales Lost Attributable to Tax
December 1990	11,459	15,567	+4,108		
January 1991	7,013	4,441	-2,572		
February 1991	8,450	5,302	-1,536	-1,606	-19.0%
March 1991	10,215	7,777		-2,438	-23.9%
April 1991	9,596	7,758		-1,838	-19.2%

**Comparisons are of BMW, Jaguar, Mercedes-Benz, and Porsche sales of models subject to the luxury tax. These models account for the majority of vehicles sold in the high-line category.*

Source: *Ward's Automotive Reports;* TBS analysis.

TBS projected what sales levels in 1991 would have been without the luxury tax ("normal" sales levels) from the high-line sales level's historical relationship to that of the overall passenger car market. Overall passenger car sales figures for the first quarter of 1991 show a steep decline in demand.

In January and February, sales were far below "normal" levels. This is in large part attributable to the unusually high sales levels of December, during the tax-avoidance buying rush.

Sales of high-line cars remained below expected "normal" levels in late February as well as through March and April. This clearly points to the same sort of permanent long-term shrinkage in demand observed in the case of the Mercedes-Benz 300E.

Our analysis assumes, conservatively, that *all* of the sales attributed to the buying rush in December would, without the tax, have been transacted in January and early February. However, if we had assumed such sales would have been spread out over a longer period of time, the permanent loss of demand calculated above would be considerably greater. However, it seems clear that the luxury tax has caused a permanent drop in demand for high-line cars of *at least* 20 percent.

Decline in Demand: $1.31 Billion in Lost Retail Sales for High-Line Dealerships

Using 1990's high-line sales base of 121,581 (see Appendix A), a 20 percent decline amounts to lost sales of 24,316 vehicles during 1991. At a weighted average price of $54,000 per vehicle retailed,* this represents approximately $1.31 billion in lost retail sales for high-line dealerships.

Initially, a tax on luxury goods would appear to be a natural method of progressive taxation. However, a recent Congressional Research Service report implicitly disputes this view.**

* Although the majority of the high-line vehicles carry an MSRP of $40,000 to $50,000, the weighted average price is $54,000, because some of the vehicles in this category carry a price significantly greater than $50,000.

** "The primary economic effect of excise taxes is to interfere with the private sector's consumption and production decisions; they are desirable taxes when such interference is the Government's goal, as with regulatory taxes, but they are not well suited to producing a progressive distribution of tax payments. . . . Judgments as to what constitute luxuries have been highly subjective." Louis Alan Talley, Jack Taylor, and Dennis Zimmerman, "CRS Report for Congress: History and Economics of U.S. Excise Taxation of Luxury Goods," Congressional Research Service, The Library of Congress, June 17, 1987 (Updated April 2, 1991).

Chapter 2
Effect of the Luxury Tax on Small Businesses and Their Employees

Dealership Profitability at an All-Time Low

Total dealership profitability has declined steadily since 1986. Decreasing profitability of new-vehicle sales has been driving this decline.

Dealership Profitability for All Franchised Automobile Dealers
(Net Profit as a Percentage of Total Sales)

	Total Dealership	New Vehicles
1986	2.2	2.3
1987	1.9	1.6
1988	1.7	1.1
1989	1.0	0.1
1990	1.0	(0.1)

Source: National Automobile Dealers Association.

High-Line Dealerships Experiencing a Similar Decline in Profitability

Nearly all cars affected by the luxury tax are sold by BMW, Jaguar, Mercedes-Benz, and Porsche dealers. These high-line dealerships have also experienced declining profitability; the percentage of unprofitable dealerships has increased over the last few years.

Percentage of High-Line Car Dealerships That Are Unprofitable	
1987	16.6%
1990	27.5%

Source: BMW, Jaguar, and Mercedes-Benz importers.

Increasing Rate of Unprofitable High-Line Dealerships Going Out of Business

The percentage of unprofitable dealers forced out of business almost doubled in 1989 and again in 1990. Given the worsening condition of new-vehicle sales department profitability, this trend is likely to continue. TBS estimates that the 1991 percentage of unprofitable dealers going out of business will also be double that of 1990, or approximately 20 percent. Since implementation of the luxury tax, the number of dealers losing money has increased substantially. As of the end of the first quarter of 1991, 505, or 55 percent, of high-line dealerships were in a loss position. If 20 percent of these unprofitable dealerships go out of business, 100 dealerships will close their doors in 1991.

Number and Percentage of Unprofitable High-Line Dealerships Forced Out of Business

	1988	1989	1990	1991
Number of Unprofitable Dealers	208	327	254	505
Number of Dealers That Have Gone Out of Business	6	20	27	100*
Percentage of Unprofitable Dealers That Have Gone Out of Business	3%	6%	11%	20%*

* Projected.

Source: U.S. high-line importers; TBS analysis.

High-Line Dealership Closings Caused by Luxury Tax: A Loss of 2,150 Jobs

We believe it would be conservative to assume that approximately half of these dealerships would have gone out of business even if the luxury tax had not been imposed. TBS concludes, therefore, that the closing of the remaining projected 50 dealerships can be ascribed to the effects of the luxury tax. In 1990, these dealerships employed 43 people on average. Losing 50 dealerships will result in the loss of approximately 2,150 jobs.

Chapter 3
Employment Effect in Surviving Dealerships

High-Line Salesperson Compensation Related to Sales Revenues and Profit Margins

Surviving high-line dealerships will be adversely affected by the projected 20 percent downturn in sales caused by the luxury tax.

Automobile dealers compensate their salespeople primarily through commissions based on the gross profit of units they have sold. When dealership volume and gross profit per unit both drop, dealerships must lay off salespeople to keep the incomes of remaining salespeople high enough to retain them.

Salesperson Layoffs at Surviving High-Line Dealerships: A Loss of 1,125 Sales Jobs Alone

In 1990, the weighted average gross margin on high-line vehicles sold was 9.3 percent. As of the end of the first quarter of 1991, this figure had dropped to 8.2 percent; this is the best figure available for 1991 projected gross margin.

On average, high-line dealerships employed 5 salespeople each in 1990; on average, each salesperson sold 25.3 vehicles. The average income of each salesperson was $36,000. For surviving dealerships to preserve the same average income per salesperson in 1991 with the projected tax-related decline in unit volume and grosses on sustained volume, salesperson employment will decline as shown in the table below. (See Appendix B.)

Effect of Changes in Sales Volume and Gross Margin on Salesperson Employment

	Units Sold	Gross Margin	Amount Spent on Salesperson Salaries as a Percentage of Gross Profit	Number of Salespeople per Dealership	Number of Salespeople
1990	117,000	9.3%	29%	5	4,625
1991	94,000*	8.2%*	29%*	4*	3,500*
Net Effect of Tax					(1,125)

* Projected.

Source: BMW, Jaguar, and Mercedes-Benz importers; TBS analysis.

The projected 20 percent decrease in sales, accompanied by the 12 percent decline in gross margins, will cause high-line dealerships to lay off 1,125 salespeople. A survey of high-line dealers supports this estimate; on average, the dealers contacted intend to lay off 1 to 2 people per dealership in 1991; many have already done so. In addition, dealerships will lay off service and clerical help as sales fall. We have not estimated the magnitude of these layoffs. Because our employment figures do not include these additional job losses, our projection of dealership employment effects should be considered conservative.

Chapter 4
Secondary Employment Effect of the Luxury Tax

Luxury Tax Will Reduce Volume Through Vehicle Processing Centers: A Loss of 45 Jobs

Importers of high-line cars maintain vehicle processing centers (VPCs) in most ports where these vehicles arrive. These VPCs repair shipping damage, install accessories, and administer customs paperwork. Each of these importers owns its own VPCs, to ensure the vehicle processing procedure meets its own quality standards.

The high-line importers operate a total of 10 VPCs, each of which employs an average of 30 people. The 20 percent drop in volume caused by the luxury tax on vehicles over $30,000 will translate into a 15 percent drop in the flow of vehicles through the VPCs (25 percent of the vehicles passing through these VPCs cost the consumer less than $30,000, and are therefore not subject to the luxury tax). This volume reduction will cause approximately 45 people to lose their jobs. While this number is relatively small compared to the 3,275 people expected to lose their jobs as a result of dealership closings and layoffs, it highlights the ripple effect of the luxury tax on the economy.

We have not attempted to calculate the additional secondary employment effects of the luxury tax on other sectors of the economy, such as the effects on ports, the transportation sector, advertising agencies, newspapers, and radio and television stations. Thus, our estimate of the ripple effect clearly is conservative.

Chapter 5
Differing Effects of the Luxury Tax on European and Japanese Makes

Luxury Tax Affects the Price of High-Line European Makes Significantly More Than That of High-Line Japanese Makes

A greater proportion of the price of European high-line vehicles is subject to the luxury tax than that of Japanese high-line cars such as the Lexus LS400 and Infiniti Q45. This results in a price advantage in excess of sticker-price differences for most Japanese cars in this category. For the average Japanese high-line vehicle, which costs $40,000, the luxury tax amounts to $1,000, or 2.5 percent of the purchase price. For the average European high-line vehicle, which costs $54,000, the luxury tax amounts to $2,400, or 4.4 percent of the purchase price.

The effect of this price advantage is apparent in the sales results for January–April 1991. As the data below indicate, Japanese high-line car sales changed at a rate similar to that of overall passenger car sales, while European high-line car sales plummeted in comparison. The luxury tax appears to have given a competitive advantage to Japanese high-line cars over European high-line makes during the first four months of 1991.

Change in Sales from Previous Year: Japanese and European High-Line Cars

	Overall Passenger Car Sales	Japanese High-Line Car Sales	European High-Line Car Sales
January-April 1991	(16.6%)	(17.4%)	(37.0%)

Source: *Ward's Automotive Reports.*

Chapter 6
Fiscal Effect of the Luxury Tax

Influence on Customs Duties: A Loss of $22.5 Million

The federal government collects 2.5 percent of the dutiable value* of a vehicle as a customs duty when it is imported into the United States. The projected minimum 20 percent drop in sales attributed to the luxury tax will therefore reduce the amount of customs duties collected. Specifically, sales will be reduced by 24,316 units, resulting in a loss of at least $22.5 million for the federal government in 1991 alone.

Total Lost Customs Duty Revenues

MSRP Range	1990 Percentage of Units Sold In Range**	1991 Lost Unit Sales by MSRP Range	Dutiable Value per Vehicle	1991 Duties Lost from Luxury Tax
$30,000-40,000	20.8%	5,000	$25,400	$3,175,000
$40,000-50,000	34.4%	8,000	32,600	6,520,000
$50,000-60,000	11.2%	3,000	39,900	2,992,500
$60,000-70,000	24.8%	6,000	47,100	7,065,000
Over $70,000	8.8%	2,000	54,300	2,715,000
Total	100.0%	24,000		22,467,500

**Of the total combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche models subject to the tax.

Source: *Ward's Automotive Reports;* TBS analysis.

* TBS calculated dutiable value of vehicles by subtracting an estimated 20 percent for dealer margin and an estimated 15 percent for importer gross margin from the MSRP.

Effect on Income Tax Revenues: A Loss of at Least $26.0 Million

High-line dealerships forced into an unprofitable position by the luxury tax will pay no income tax to the federal government in 1991. TBS projects the federal government will lose at least $26.0 million in income tax revenues from these dealerships.

Number of 1991 Unprofitable Dealerships That Were Profitable in 1990		Average 1990 Net Profit Before Taxes of These Dealerships		Corporate Tax Rate		Lost Federal Income Tax Revenues
251	X	$305,079	X	34%	=	$26.0 million

Source: U.S. high-line importers.

Reduced Profitability Will Result in Further Income Tax Revenue Loss

In addition to this 1991 loss, the federal government will lose income tax revenues in 1992 and beyond because the dealers will be able to carry their losses forward and offset future earnings. Further, dealerships that remain profitable will pay less income tax than they did in 1990, because of their decreased profitability.

Government Luxury Tax Revenues Deferred by Leases

According to U.S. high-line importer data, approximately 40% of high-line vehicles "sold" by dealers are actually leased. Luxury tax payments on leased vehicles are spread over the life of the lease. Because it does not gain use of the funds until later, the federal government earns less income from taxes that are deferred. Tax revenue from a leased vehicle, therefore, will be less than tax revenue from a vehicle sold outright. And because a significant percentage of high-line vehicles are leased, total revenue from the luxury tax on sales of these vehicles will fall short of projections based on simple sales figures for each year.

Influence on Gas Guzzler Tax Revenues: A Loss of $22.5 Million

In 1990, 56% of high-line vehicles subject to the luxury tax were also subject to the gas guzzler tax. In 1991, this tax ranges from $1,000 to $7,700 per vehicle. The 20 percent decrease in high-line sales caused by the luxury tax will reduce revenues generated by the gas guzzler tax by $22.5 million.

Gas Guzzler Tax Revenue Lost As a Result of Luxury Tax

1991 Gas Guzzler Tax per Vehicle	1990 Percentage of Gas Guzzler Tax Vehicles Taxed This Amount	1991 Lost Unit Sales	1991 Gas Guzzler Tax Lost from Luxury Tax
$0	44.0%	10,560	$0
$1,000	6.4%	1,536	1,536,000
$1,300	27.7%	6,648	8,642,400
$1,700	6.6%	1,584	2,692,800
$2,100	4.8%	1,152	2,419,200
$2,600	6.7%	1,608	4,180,800
$3,000	2.1%	504	1,512,000
$3,700 - $7,700	1.7%	408	1,509,600
Total	100.0%	24,000	22,492,800

Source: *Ward's Automotive Reports*; *New Car Cost Guide*; TBS Analysis.

Effect on State Sales Tax Revenues: A Loss of $64.5 Million

State governments collect sales tax on vehicles. Reduced demand for vehicles will cut directly into their revenues. Several states, including Kansas and California, have considered imposing their own state luxury tax, apparently with the hope of recovering some of the expected loss of sales tax revenues. Using a weighted average sales tax rate of 5.2 percent (based on the state-by-state distribution of high-line car sales), TBS concludes that states can expect to lose a total of $64.5 million in revenues.

State Sales Tax Revenue Lost As a Result of Luxury Tax

MSRP Range	1991 Lost Sales	Sales Tax Lost per Vehicle	1991 State Sales Tax Lost from Luxury Tax
$30,000-40,000	5,000	$1,820	$9,100,000
$40,000-50,000	8,000	2,340	18,720,000
$50,000-60,000	3,000	2,860	8,580,000
$60,000-70,000	6,000	3,380	20,280,000
Over $70,000	2,000	3,900	7,800,000
Total	24,000		64,480,000

Source: TBS analysis.

Overall Cost of the Luxury Tax for Federal and State Governments: At Least $135.5 Million

The minimum 20 percent decrease in high-line sales caused by the luxury tax will directly affect federal customs duty revenues, gas guzzler tax revenues and state sales tax revenues, while the decreased profitability of the high-line dealerships will cost the federal government lost income tax revenues. In total, the luxury tax will cost government at least $135.5 million.

Source	1991 Lost Government Revenues
Lost Customs Duties	$22.5 million
Lost Federal Income Tax Revenues	$26.0 million
Lost Gas Guzzler Tax Revenues	$22.5 million
Lost State Sales Tax Revenues	$64.5 million
Total Cost of Luxury Tax	$135.5 million

We have not attempted to estimate other costs to the federal government, such as the cost of enforcing the tax or paying unemployment benefits to workers who lose their jobs as a result of the imposition of the luxury tax. Thus, our estimates of the impact appear to be conservative.

Appendix A
Methodology for Determining Luxury Tax Effect on Demand

Step 1: Compare high-line car market to overall passenger car market prior to luxury tax impact

TBS compared the combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche (minus sales of the Mercedes 190 and the BMW 3-Series, which are generally not subject to the luxury tax) to the overall passenger car market for January 1990 through March 1991 on a month-by-month basis. The percentage change from the previous year of the combined sales of the four European manufacturers rarely varied more than 10 percentage points from the percentage change from the previous year of overall passenger car sales from January 1990 to November 1990. In the instances where the variance was greater than 10 percentage points, the variance was positive, meaning the combined sales of the four manufacturers outperformed the overall market.

In other words, before implementation of the luxury tax, the sales pattern of the four European manufacturers tracked relatively closely to the rest of the market.

Combined Sales and Overall Passenger Car Sales Prior to Luxury Tax Imposition

1990	Combined Sales of BMW, Jaguar, Mercedes, and Porsche*	Percentage Change from Previous Year of Combined Sales	Overall Passenger Car Sales	Percentage Change from Previous Year of Overall Passenger Car Sales	Variance
Jan	8,888	(0.9)	743,334	4.4	(5.3)
Feb	9,288	(2.5)	716,580	(3.9)	1.4
Mar	11,325	2.7	850,285	(3.3)	6.0
Apr	10,627	7.4	802,589	(11.3)	18.7
May	10,731	7.6	872,411	(9.5)	17.1
Jun	10,409	(6.3)	857,238	(3.6)	(2.7)
Jul	8,718	(11.2)	803,240	(4.1)	(7.1)
Aug	9,660	(8.5)	785,968	(18.4)	9.9
Sep	10,159	2.6	768,994	(7.4)	10.0
Oct	9,545	(2.8)	787,721	6.6	(9.4)
Nov	10,774	1.5	661,216	(1.7)	3.2
Jan-Nov Total	110,122	(1.0)	8,649,554	(5.3)	4.3

*Does not include sales of the Mercedes 190 and BMW 3-Series, which are generally not subject to the luxury tax.

Source: *Ward's Automotive Reports.*

Step 2: Establish a "normal" pattern of difference between the luxury car market and the overall passenger car market

During the sales period from January to November 1990, sales of BMW, Jaguar, Mercedes-Benz, and Porsche vehicles decreased 1.0 percent from the prior year's levels. The overall passenger car market fell 5.3 percent over the same period; this indicates that BMW, Jaguar, Mercedes-Benz, and Porsche performed better than the overall market by 4.3 percent.

	Combined Sales of BMW, Jaguar, Mercedes, and Porsche*	Percentage Change from Previous Year of Combined Sales	Overall Passenger Car Sales	Percentage Change from Previous Year of Overall Passenger Car Sales	Variance
January-November 1990	110,122	(1.0)	8,649,554	(5.3)	4.3

*Does not include sales of the Mercedes 190 and the BMW 3-Series.

Source: *Ward's Automotive Reports.*

Step 3: Compare luxury car market to overall passenger car market after luxury tax

During December 1990 and January, February, March, and April 1991, the luxury tax distorted the sales pattern for BMW, Jaguar, Mercedes-Benz, and Porsche. The percentage change from the previous year for those manufacturers varied more than 12 percentage points from the percentage change from the previous year of overall passenger car sales. Implementation of the luxury tax created two significant distortions: 1) a jump in sales during December 1990, driven by purchasers avoiding the tax, and 2) dramatic declines in sales in January, February, March, and April 1991, once the tax was implemented.

Combined Sales and Overall Passenger Car Sales After Luxury Tax Imposition

	Combined Sales of BMW, Jaguar, Mercedes, and Porsche*	Percentage Change from Previous Year of Combined Sales	Overall Passenger Car Sales	Percentage Change from Previous Year of Overall Passenger Car Sales	Variance
Dec	15,567	43.9	651,110	1.6	42.3
1991 YTD	25,278	(37.0)	2,596,843	(16.6)	(20.4)
Jan	4,441	(50.1)	554,540	(25.4)	(24.6)
Feb	5,302	(42.9)	621,554	(13.3)	(29.6)
Mar	7,777	(31.3)	730,126	(14.1)	(17.2)
Apr	7,758	(27.0)	690,623	(14.0)	(13.0)

*Does not include sales of the Mercedes 190 and the BMW 3-Series.

Source: *Ward's Automotive Reports.*

Step 4: Determine the difference between results expected without the luxury tax and the actual results with the luxury tax

We assumed that BMW, Jaguar, Mercedes-Benz, and Porsche would have continued to outperform the overall market by 4.3 percent for December 1990 through April 1991 had Congress *not* imposed the luxury tax. We termed these results expected without the tax "normal" sales results. Comparing the "normal" results with the actual results demonstrates that the increase in sales for December 1990 offsets the declines in January and part of February.

"Normal" vs. Actual Results of the Combined Sales*

	Actual Percentage Change from Prior Year of Overall Passenger Car Sales	Expected Percentage Change from Prior Year of Combined Sales*	Actual Percentage Change from Prior Year of Combined Sales*	"Normal" Sales Volume of Combined Sales*	Actual Sales Volume of Combined Sales*	Aberration in Units
December 1990	1.6	5.9	43.9	11,459	15,567	4,108
January 1991	(25.4)	(21.1)	(50.1)	7,013	4,441	(2,572)
February 1991	(13.3)	(9.0)	(42.9)	8,450	5,302	(3,148)
March 1991	(14.1)	(9.8)	(31.3)	10,215	7,777	(2,438)
April 1991	(14.0)	(9.7)	(27.0)	9,596	7,758	(1,839)

*Combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche, not including sales of the Mercedes 190 and the BMW 3-Series.

Source: *Ward's Automotive Reports;* TBS analysis.

Had the luxury tax not created a surge in December sales, we would have expected the combined sales to outperform the overall passenger car market by 4.3 percent (as it had during the period of January through November 1990), which would have resulted in an increase of 5.9 percent over December 1989. Instead, the combined sales exhibited a 43.9 percent increase. This percentage jump translates into an incremental 4,064 BMW, Jaguar, Mercedes-Benz, and Porsche vehicles being sold during December beyond what would have been expected.

Sales for January and February 1991 decreased dramatically beyond what would have been expected, given the changes in the overall passenger car market. Given that the overall passenger car market was off 25.4 percent in January and 13.3 percent in February, the combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche would have been expected to drop 21.1 percent in January and 9.0 percent in February – outperforming the market by 4.3 percent. Instead, the combined sales plummeted 50.1 percent in January and 42.9 percent in February. This translates into 2,572 vehicle sales lost in January and 3,148 vehicle sales lost in February.

Comparing the increase in December sales to the decreases in the following months, we can assume that the decrease in January and a portion of the decrease in February were compensated for by the increase in December. To be more specific, the 2,572 vehicle sales lost in January and 1,536 of the vehicle sales lost in February can be attributed directly to the 4,108 vehicle sales gained in December (2,572 + 1,536 = 4,108).

Once the abnormal December increase is absorbed by the slump in sales in January and February, a "normal" combined sales pattern would return to mimic the pattern of the overall passenger car market. In other words, for the remainder of February and all of March and April, we would expect the combined sales to outperform the market by 4.3 percent. The overall passenger car market dropped 13.3 percent in February, 14.1 percent in March, and 14.0 percent in April; "normal" combined sales, therefore, would drop 9.0 percent in February, 9.8 percent in March, and 9.7 percent in April. The actual result, however, was a much more dramatic drop in combined sales, even after accounting for the December increase.

"Normal" and Actual Results of the Combined Sales* After Accounting for the December Increase in Sales

	Actual Percentage Change from Prior Year of Overall Passenger Car Sales	Expected Percentage Change from Prior Year of Combined Sales*	Actual Percentage Change from Prior Year of Combined Sales*	"Normal" Sales Volume of Combined Sales*	Actual Sales Volume of Combined Sales*	Aberration in Units	Aberration in Percentage
December 1990	1.6	5.9	43.9	11,459	15,567	4,108	
January 1991 Completely offset by Dec. Increase	(25.4)	(21.1)	(50.1)	7,013	4,441	(2,572)	
February 1991 Not accounting for the Dec. Increase	(13.3)	(9.0)	(42.9)	8,450	5,302	(3,148)	
February 1991 Accounting for the Dec. Increase	(13.3)	(9.0)	(26.4)	8,450	6,838	(1,612)	(19.0)
March 1991 Not offset by Dec. Increase	(14.1)	(9.8)	(31.3)	10,215	7,777	(2,438)	(23.9)
April 1991 Not offset by Dec. Increase	(14.0)	(9.7)	(27.0)	9,596	7,758	(1,838)	(19.2)

*Combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche, not including sales of the Mercedes 190 and the BMW 3-Series.

Source: *Ward's Automotive Reports;* TBS analysis.

After accounting for the December increase, the true effect of the luxury tax on the sales of BMW, Jaguar, Mercedes-Benz, and Porsche can be analyzed. A review of the February, March, and April results after accounting for the December effect reveals a continuing loss of sales. In February, the combined sales were down 26.4 percent; at "normal" sales levels they would have been down 9.0 percent. This amounts to a unit sales loss of 19.0 percent. In March, the combined sales were down 31.3 percent; at "normal" sales levels they would have been down 9.8 percent. This amounts to a unit sales loss of 23.9 percent. In April, the combined sales were down 27.0 percent; at "normal" sales levels they would have been down 9.7 percent. This amounts to a unit sales loss of 19.2 percent. In other words, after accounting for the December increase in sales and for the general downturn in the overall passenger car market, the sales level of BMW, Jaguar, Mercedes-Benz, and Porsche has normalized at *20 percent below* the sales level of 1990. This 20 percent decrease is directly attributable to the luxury tax.

Step 5: Demonstrate that the gap is not nameplate-related (not due to sudden consumer avoidance of BMW or Mercedes-Benz) by comparing Mercedes 190 and BMW 3-Series sales to sales of other models

Percentage Change in Sales from Prior Year of the BMW 3-Series and the Mercedes 190

	BMW 3-Series	Total BMW without the 3-Series	MB 190	Total MB Without the 190	Overall Passenger Car Market
January-November 1990	(8.8)	(2.8)	(1.4)	1.4	(5.3)
December 1990	16.0	84.0	(11.6)	37.9	1.6
January-April 1991	(20.8)	(30.0)	17.9	(34.1)	(16.6)

Source: *Ward's Automotive Reports.*

The severe drop in BMW and Mercedes-Benz sales during January, February, March, and April 1991 (compared with sales for the same period of the prior year) *cannot* be attributed to a sudden market shift away from the BMW and Mercedes nameplates. A comparison of sales of the BMW 3-Series and the Mercedes 190, vehicles which are relatively unaffected by the luxury tax, with the sales of BMW and Mercedes vehicles that are affected and with the overall passenger car market reveals the continued desirability of the unaffected vehicles. BMW 3-Series sales for January through April 1991 were off 20.8 percent from the same period of the prior year. This corresponds with a 16.6 percent drop for the overall passenger car market, which indicates that BMW 3-Series vehicles track closely with the market. Other BMW vehicle sales were off 30.0 percent, a significant decline compared to the overall market. Mercedes 190 vehicles presented an even stronger showing, with a 17.9 percent *increase* for January through April 1991 over the same period of the prior year. This compares again with a 16.6 percent drop in overall passenger car sales and a 34.1 percent drop in the sales of other Mercedes-Benz vehicles.

Step 6: Project the luxury tax effect on BMW, Jaguar, Mercedes-Benz, and Porsche sales for the entirety of 1991

The combined sales of BMW, Jaguar, Mercedes-Benz, and Porsche have suffered a substantial decrease attributable to the luxury tax. Current sales levels have stabilized at 20 percent below last year's levels. Assuming a 1990 combined sales base of 121,581 (equal to last year's actual of 125,689 vehicles sold minus the December aberration of 4,108 vehicles sold), a 20 percent decline represents lost sales of 24,316 vehicles during 1991. At a weighted average price of $54,000 per vehicle retailed, this represents approximately $1.31 billion in lost retail sales for those dealerships.

Appendix B
Notes on Determining Employment Effect in Surviving Dealerships

Effect of Sales Decline and Lower Gross Margins on Employment

	Units Sold	Gross Margin	Gross Profit Generated by Sales (in thousands)	Amount Spent on Salesperson Salaries (in thousands)	Amount Spent on Salesperson Salaries as a Percentage of Gross Profit	Number of Dealers	Number of Salespeople per Dealership	Number of Salespeople
1990	117,000	9.3%	$585,000	$166,500	29%	925	5	4,625
1991	94,000*	8.2%*	$413,600*	$1[illegible]9,944*	29%*	875*	4*	3,500*
Net Effect of Tax								(1,125)

* Projected.

Source: *Ward's Automotive Reports*; U.S. high-line importers; TBS analysis.

- Units sold represent BMW, Jaguar, and Mercedes-Benz vehicles sold minus the Mercedes 190 and the BMW 3-Series, which are generally not subject to the luxury tax.
- Gross margin is an average of the gross margins obtained on the sale of the different vehicles, weighted by vehicle volume.
- At an average price of $54,000 per vehicle, the gross profit generated in 1990 was $5,000 per vehicle; in the first quarter of 1991 it was $4,400 per vehicle.
- The 1990 amount spent on salesperson salaries is derived by multiplying the number of salespeople by the average salary, $36,000
- The 1991 amount spent on salesperson salaries is derived from the assumption that the amount spent on salesperson salaries as a percentage of gross profit will remain the same (29 percent) in 1991.

PREPARED STATEMENT OF KATHLEEN BROWN

Introduction

Mr. Chairman and honorable members of the Subcommittee, I appreciate the opportunity to testify before you today. As California's State Treasurer, my goal is to assist California's governmental agencies in meeting their financing needs. I am here today to urge your support for a bill which would greatly assist state and local governments across the country in tax-exempt financing.

California's Growing Needs

As many of you know, California is suffering through a major fiscal crisis. What may not be well known, since we are a relatively young state, is that we have an infrastructure crisis, as well. Our major roads are gridlocked more often than not, making it difficult for workers to get to their jobs and for businesses to get goods to market.

While we haven't had a bridge collapse like Connecticut's Mianus River Bridge or closed like New York's Williamsburg Bridge, Los Angeles saw a car nearly swallowed by an eight-foot hole near the Pacific Coast Highway caused by a rotting sewer pipe. If this sounds like a grade-B Hollywood film, we Californians can also give you our own personal "earthquake" horror stories following the October 17, 1989 "little big one." For purposes of this committee, suffice it to say thousands of our public buildings are not up to seismic safety standards.

And then, there are our schools. Because school population is expected to increase an average of 200,000 students each year for the next several years, we will need to build 11 classrooms each day, 365 days a year for the next 10 years simply to meet current enrollment projections.

Our water supplies have also been stretched following a five-year drought and a depletion of our ground water.

As my fellow state treasurers will testify if they have not already, the problems of an overburdened infrastructure are troubling for many state governments. They are particularly troubling for California because of its rapidly growing population. California has a population of about 30 million residents, approximately seven million more than in 1980. This means our infrastructure must support use by a new population base the size of the states of Oklahoma, Arkansas, Montana and Delaware combined.

If trends continue, our population will climb to more than 34 million by the end of the century. To meet some of the needs of this growing population, the state plans on spending a minimum of $55 billion in the next 10 years on capital facilities.

The following statistics illustrate the magnitude of the problems we face in trying to provide infrastructure and facilities for our growing population:

- To accommodate the 1.4 million increase in K-12 students in the next 10 years, the State will need $11 billion to finance an additional 26,000 classrooms.

* To house the inmate population that is expected to swell to 137,000 in 1994, another $3 billion to $3.5 billion is needed for prison construction.

* And, to bring all sewage treatment plants in California up to federal health standards, it would cost about $5.6 billion and at least $8 billion by the year 2005.

Unfortunately, federal resources to help meet these needs have dwindled since the 1960's (see attached graph). For example, federal spending for major public capital investments has dropped from 4.4% of gross national product to a 2.4% in the last 30 years, according to the Office of Management and Budget. When measured in constant dollars, the federal government has provided states with less financial support. This is particularly difficult for California and our local governments which are now facing unprecedented budget shortfalls caused by the national economic recession and exacerbated by our recent freeze and the long-lasting drought.

With reduced federal and state funding, tax-exempt financing, with its attendant lower debt service costs, plays an increasingly important role for state and local governments as they attempt to finance critically-needed public improvements. In fact, since 1985, state and local governments have issued nearly $146 billion in tax-exempt financing to fund a variety of capital needs. To help ensure that our limited monetary resources end up where they are most needed -- in the actual building of roads, sewers, schools and jails -- my goal is to diligently try to minimize costly administrative overhead. Unfortunately, the arbitrage and rebate compliance requirements imposed on tax-exempt financings by the federal tax laws are a prime example of a kind of insidious administrative burden, and that is why I am before you today.

Restrictions of the Tax Reform Act of 1986

The arbitrage and rebate rules were originally and appropriately intended to cure abusive tax-exempt financings. However, like many well-intended cures, these regulations have caused a series of unintended consequences that not only drive state and local government officials to suffer Excedrin arbitrage headaches, but more importantly, they have proven to be extremely costly for our taxpayers. To comply with these rules, financially-strapped state and local governments spend thousands of dollars and devote hundreds of hours of staff time.

Let me share with you California's experience. The State was unable to issue any general obligation bonds for more than one year after the effective date of the Tax Reform Act of 1986; it took this amount of time to determine how best to comply with the regulations and to implement the changes to state laws and procedures that were needed to do so. Unfortunately, this "best method" of compliance is also extremely costly.

Since the State issues bonds on behalf of local entities (such as schools) that then oversee the actual construction process, the State was faced with the dilemma of attempting to ensure that compliance with these changing and often confusing requirements was adhered to by a myriad of small

local entities that in many cases lacked the necessary systems. Since the risk of noncompliance with the federal tax laws is so draconian, California decided to follow a fail-safe method of compliance. Thus, the State chose to advance construction funds at taxable rates and to take out these funds with tax-exempt financing only when construction was complete. This interim borrowing process costs the State an additional $30 million annually in interest costs, dollars which could, and should, be used instead to build more schools and other critically-needed local infrastructure.

Even with this advance funding process, which is presumably simpler than arbitrage tracking, we have had to add eight people in the Treasurer's Office and five people in the Controller's Office whose sóle responsibility is to respond to the requirements of the 1986 Tax Reform Act at the state level.

For local agencies, the administrative and monetary burdens associated with rebate and arbitrage compliance are just as substantial. For example, officials with the City of Los Angeles estimate that they will spend about $25,000 this year to hire outside experts to comply with the arbitrage rebate rules. In addition, countless hours of staff time have been devoted to the rules rather than to overseeing the construction of important city projects.

With California cities, counties, school districts and other special districts issuing $10.6 billion during 1990 in 722 separate issuances, even a small cost per issue becomes significant in the aggregate.

The Importance of S.913

With this by way of background, let me now address some of the specific provisions of Senator Baucus's bill, the Tax-Exempt Bond Simplification Act of 1991, and tell you why I support passage of this important legislation.

First, S.913 will increase the small issuer exception to arbitrage rebate from $5 million to $25 million.

This proposed revision of the small issuer exception would benefit cities, counties, school districts and other governmental entities in California. Many of these entities are small and unable to keep up with the changing arbitrage and rebate rules. But their financing needs are substantial, particularly because of their rapidly growing populations.

The experience of Santa Barbara County provides an example of the difficulty of compliance with rebate rules. That County has had one tax-exempt issuance a year since 1986, mostly in the $5 million to $25 million range. With that volume of business, the County Treasurer decided to implement an in-house rebate tracking system rather than pay outside rebate compliance experts. However, the rebate rules have changed so often that different rules apply to each issuance and the rules are so complicated that the County officials are concerned that they will make an inadvertent error even if they use their best efforts to comply. At a time when this County, like all California counties, is facing a serious budget shortfall, the County has reluctantly decided to hire an outside expert at a cost

of approximately $12,000 per year to ensure compliance. No one would argue that such money would be better spent on desperately-needed county services and facilities.

The $5 million exception in current law exists because it was recognized that the small amount of money the Treasury would obtain from rebate compliance did not justify the administrative burdens. A $25 million exception is justifiable on the same basis and would substantially increase the number of California agencies who would be able to go about their business without the out-of-pocket costs and/or staff time necessary for rebate compliance. Based on 1990 figures, 37% of governmental bond issuers in California issued between $5 million and $25 million.

A $25 million exception would also save issuing entities thousands of dollars. We estimate that there were 284 agencies issuing bonds totalling between $5 million and $25 million in 1990 alone. While these agencies completed 382 transactions in 1990, they paid a total of about $800,000 in arbitrage compliance costs.

<u>Second, S.913 will make retroactive the 1989 exception from rebate for construction projects.</u>

As I have described earlier, rebate compliance is costly and burdensome. Congress in effect recognized this fact by enacting the 1989 two-year construction period exception. The same logic that brought relief prospectively justifies relief retroactively. Uniform tax rules would be more comprehensible and much easier to administer.

<u>Third, S.913 will increase the small issuer bank deductibility provision from $10 million to $25 million.</u>

The 1986 Tax Reform Act eliminated the incentive for banks to invest in tax-exempt bonds. Historically, a local bank was an efficient source of credit for a local agency. The bank was familiar with the local economy and the local agency and could advance money on a tax-exempt basis without the need for an offering document. Since the 1986 Tax Reform Act, however, banks' appetites for tax-exempt bonds have greatly diminished. Today, the market for issues other than small issues has become primarily institutional or retail. Many regional investment banking firms have closed in recent years, and whether or not large national investment banking firms are going to be interested in underwriting small issues is uncertain.

This aspect of S.913, if enacted, would have the following positive effects for those issuers with issues not exceeding a total of $25 million annually:

1. It would provide a cost-effective source of capital by recreating the historical partnership between the local private sector and the government, thus providing an alternative to an underwriting with a full-blown public offering.

2. It would provide a safe investment vehicle for local banks that would also meet local needs.

3. By bringing banks back into the market, S.913 would increase the demand for tax-exempt bonds and thus reduce interest rates.

<u>Fourth, S.913 will eliminate the requirement to yield restrict investments which are not subject to rebate and will require the issuer to rebate only 90% of the arbitrage earned.</u>

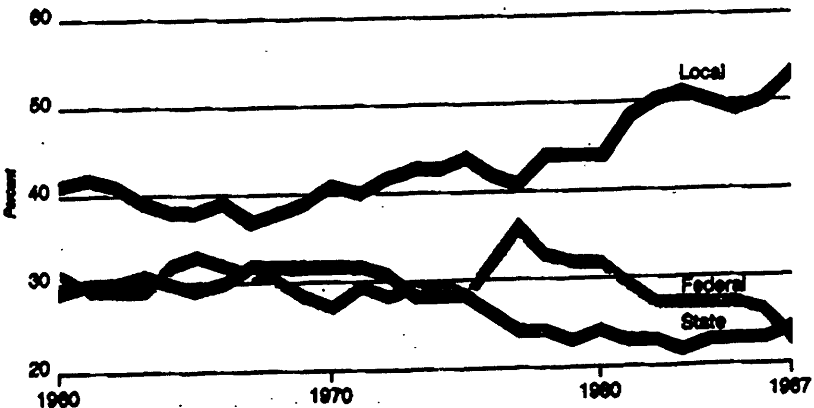
The present rules eliminate the incentive for issuers to invest above the bond yield, even though they could do so and meet the requirements of the law. Inevitably, the result is that the issuers and/or the federal government lose an opportunity to earn much-needed revenue. As a practical matter, the only way to change this course of conduct while still getting compliance with the market price rules is to give issuers an incentive to maximize their return. Allowing them to keep 10% of the interest earned would provide such an incentive.

Moreover, eliminating the yield-restriction requirement would mean that governmental officials would once again be able to invest in instruments with which they are familiar and for which they can evaluate liquidity, risk and return.

Conclusion

With reduced state and federal funding for infrastructure needs, local governmental entities are increasingly forced to rely on tax-exempt financing. S.913 would ease some of the financial and administrative burdens now associated with this important financing tool without increasing the opportunities for abuse. S.913 will enable California and other states to invest in their futures more efficiently. I urge your support for S.913.

PERCENTAGE OF GOVERNMENT SPENDING ON INFRASTRUCTURE: 1960 TO 1987



SOURCE: Population Reference Bureau, January 1990; Apogee Research

Prepared Statement of Senator Richard Bryan

Mr. Chairman, I am testifying today in support of S. 267, legislation introduced by Senator Reid and myself to eliminate the state source income tax of retirement income. I am very pleased that Mr. Bill Hoffman of Carson City, Nevada is here to testify today; Mr. Hoffman and his group RESIST have been extremely successful in bringing the problem of source taxation of pensions to the attention of both Congress and the general public.

As we all know, many individuals choose to retire to states other than where they spent their working life. There are many reasons for such moves, and I think we all agree that retirees have the right to live wherever they choose.

As Mr. Hoffman will describe in greater detail, many American retirees are not allowed to break their ties to their former state. These individuals are not allowed to vote or receive services in their former state; nevertheless, they are forced to pay their former state income taxes on their retirement income.

In Nevada, an estimated 100,000 retirees could face this unfair and burdensome taxation.

While this problem is especially acute for retirees who move to states like Nevada, which collects no state income tax, the injustice of this "taxation without representation" should offend and outrage us all.

In addition to placing an undue burden on retirees who choose to move to a different state, the source taxes restrict the new state's ability to raise revenues, even though the new state is now charged with providing the retiree with government services.

While no one enjoys paying taxes, most of us understand the necessity for taxes, with two major caveats. First, we expect to have some sort of control, no matter how indirect, over the decision making process regarding both the assessment of the taxes and the spending of the associated revenues. As we all know, this is the very principle upon which our nation was founded. Second, we expect to receive some sort of benefit from the taxes we pay. The victims of the source tax have neither the control or the benefits most of us expect when we pay taxes. Over the past few years, I have listened to many accounts of how the source tax affects my constituents. One of the most distressing stories I have heard regarding these taxes has been reported in a Nevada newspaper. Quoting from the Las Vegas Review Journal:

> . . . Perhaps the saddest case is that of 72 year old Gertrude Eberly of Fallon [Nevada]. Nine years after moving to Nevada, she suddenly was hit with a bill for $4,000 in delinquent California income taxes. Unable to pay it all out of her $13,000 annual income, Eberly agreed to pay $50 a month to California. If she lives long enough, she might be able to pay off the debt . . .

Retirees should not be subjected to this type of abusive taxation: While there is a legitimate concern in some cases regarding deferred income, and the lack of tax payments on pension contributions in the past, such situations cannot justify a lifelong servitude to a retirees former state. Settlement arrangements can, and should, be worked out that reflect the interests of both the retirees and their former states.

I have spent most of my nearly three decades of public service at the state level. I value the right of states to govern themselves as much as any other member of this distinguished body. Nevertheless, these rights stop at the state border.

"Taxation without representation" was not tolerated by our forefathers, and cannot be tolerated today.

Mr. Chairman, I thank you again for holding this hearing, and I am hopeful that this hearing will be a step forward in our efforts to pass this important legislation.

Prepared Statement of John Chantrey

Mr. Chairman and Members of the Committee, thank you for convening this important hearing on S. 649, which would repeal the 10% excise tax on recreational boat sales.

I represent Schubert's Marine Sales and Service, which is based in Baton Rouge, Louisiana. Schubert's is the largest full-service yachting service between Houston and Mobile. We have on site representation of the two largest yacht manufacturers in the United States, Hatteras Yachts and Viking Yachts. Schubert's has a full-service fuel dock, yacht yard, and a fully inventoried parts department. We sit in the middle of two marina's that have over 1,000 boats located on Lake Chartpontrain's south shore just north of New Orleans.

At the time I purchased Schubert's in 1987, the Louisiana economy was at the bottom with the oil industry all but shut down. Suppliers of the oil industry consoli-

dated their businesses, some went bankrupt, and others moved out of state. Lousiana's economy was at its worst.

Betting that the worst was over, I purchased Schubert's. For the first two years, we survived by bringing in a larger percentage of our existing business in the Gulf area, mainly from our competitors. With the purchase of our 65 ton yacht hoist, we were able to service larger yachts going out of the state than in the past. By 1989, our economy, in the eyes of our customers, was as bad as it was going to get, and those who survived felt they were reasonably safe. In 1989, we outfitted our first major yacht in two years. This was followed by a second and third with total sales of over $1.8 million and outfitting revenues to Schubert's of over $340,000. Outfitting was broken down into one-half labor and one-half parts. New jobs were based on these sales alone. My plans for this company were on track, and we proceeded to build a modern production building with a parts and administrative section. We completed this project in October of 1990, just about the time the luxury tax was enacted.

The prospective buyers of the yachts I'm talking about are not on the roles of the rich and famous, but rather successful small business owners, doctors, and lawyers. They buy yachts that costs between $400,000 and $1.2 million. This initial cost, along with the annual maintenance expenses, represents a substantial portion of their recreational budget. Our customers use their boats regularly, not on a seasonal basis. Because of preluxury tax costs on these yachts, the luxury tax means the difference between buying or not buying a yacht. We had our first cancellation in March of 1991. My customer was buying a 70 foot Hatteras motor yacht. He sold his 45 foot yacht last year and cancelled his new boat due to the luxury tax.

This means if the luxury tax is not repealed soon, we will begin reducing our work force by a third. Not only does this mean highly skilled people lose their jobs, but the overhead costs of this newly rebuilt facility will be so high compared to our gross sales that our business may not survive and all of my thirty-five people may lose their jobs.

As a small businessman who does not have the revenue to weather a long financial storm, I have already listed my business as up for sale before I am put in a position of not having a choice. Located in the picturesque West End Park in Lake Ponchartrain, condominium developers consider our property prime for development. If the luxury tax is not repealed, I feel I have no other choice but to sell out. I ask the Committee's assistance in repealing this tax as soon as possible.

Prepared Statement of Senator William S. Cohen

Mr. Chairman, I am pleased that the Committee is holding this hearing today to consider legislation to repeal the luxury tax on recreational boats.

I am deeply concerned about the current condition of the boating industries, in my state of Maine. Since enactment of the new luxury tax, I have heard from many representative of and workers in the boating industry, both in my state and across the country, on the serious toll that this new tax is taking on their industry. The pleasure boat industry has experienced declining sales over the past two years due to the economic recession, and there is widespread concern that this new tax is exacerbating the industry's decline.

As you will hear from industry witnesses today, significant numbers of jobs—by some estimates well over 8,000 jobs—will be lost due to the new tax. Boat builders and employers in boat related industries in my state of Maine are already feeling the devastating effects of lost boat sales, in large part due to the new excise tax. The Hinckley Company in Southwest Harbor, Maine, for example, has been forced to lay-off ten per cent of its work force. As the second largest employer in Hancock County, reductions at Hinckley have taken a great toll on this part of my state. This case is certainly not unique: every Maine boat builder has reported worker lay-offs and significant slow-downs in production due to this tax. Customers are backing out of contracts once they realize that a tax is being applied to their boat purchases, thus affecting even those sales that were generated before the tax went into effect. In most cases, the workers who lose their jobs due to the slow-down have no transferable skills, and are unable to find other jobs in the state. The demise of the boating industry will quickly have a wide, ripple effect on other parts of the Maine economy, from the state government which depends upon revenues from new and used boat sales, to the hotels, restaurants, marinas, and other Maine industries that rely on a thriving recreational boat industry for their survival.

The luxury tax was included in the Budget Reconciliation Act of 1990 for two reasons: to raise revenues and to impose a tax on wealthy taxpayers. I have concerns,

however, that neither goal will be realized by this particular tax on boats. First, numerous articles and experts have noted that the administrative, collection, and compliance costs may substantially reduce, if not totally negate, the $3 million in revenues that were estimated to be raised by the tax. even more importantly, the federal government stands to lose significant amounts in income taxes that would otherwise be paid by boat builders and their employees.

Second, the real effect of this tax will not be borne solely by wealthy taxpayers. These people often have the financial means to pay the ten per cent tax, to choose to spend their money on some other item that is not taxed. Instead, the real burden of this tax falls on the hardworking men and women of the boating industry who are losing their jobs.

Mr. Chairman, I recognize that some may misconstrue efforts to repeal this tax as simply an attempt to help rich taxpayers. Nothing could be further from the truth. I, for one, fully support proposals to make wealthy taxpayers pay more in federal taxes. During the Senate debate on the budget reconciliation bill that contained this excise tax, for example, I supported amendments to increase the tax burden on upper- income taxpayers, and, ultimately, I did not support the final bill because I believed that the deficit reduction package, as a whole, disproportionately hurt low- and middle-income taxpayers, and did not place enough of the burden on the wealthy. A luxury tax on recreational boats, however, is not simply a tax on the wealthy, but rather threatens severe, harsh consequences on an already troubled industry. I ask the committee to seriously reevaluate the wisdom of the boat tax, in light of the compelling testimony you receive today on the critical condition of the industry. I urge you to consider whether the job losses, as well as administrative, collection and compliance costs outweigh the projected revenues for the tax itself. This is an issue of utmost importance to states like Maine, where the recreational boating industry constitutes a major segment of the state's economy.

Finally, I urge the committee to explore alternative means of raising the $3 million in revenue that would be raised by the boat tax. While we must, of course, take strong action to bring the deficit under control, losing the domestic boat industry and robbing thousands of their jobs is, in my opinion, far too dear a price to generate this relatively small amount of revenue.

Prepared Statement of Senator John C. Danforth

Mr. Chairman, I am proud to support S. 150, legislation to aid major colleges and universities and other charitable institutions in their efforts to expand and improve their facilities.

As part of the Tax Reform Act of 1986, Congress placed a cap on the amount of tax-exempt bonds that can be issued by organizations such as charitable groups and private colleges and universities. Because of this legislation, private colleges and universities and other philanthropic institutions may not have outstanding more than $150 million of tax-exempt obligations. But, the $150 million cap does not apply to bonds if the proceeds are used with respect to a hospital. This bill eliminates the $150 million cap for all qualified organizations. In other words, this bill.will allow private colleges and universities and other qualified charitable institutions to issue tax-exempt bonds without limitation for the purpose of building, expanding and improving their facilities and equipment. It should be noted that these tax-exempt bonds, will be treated in the same manner as governmental bonds, and that these private institutions will receive this benefit only with respect to their exempt activities.

Mr. Chairman, every day we are bombarded by reports of our Nations' competitive deficiencies. Our trade deficit grows, jobs are exported while goods are imported, and new technology is increasingly being developed overseas. We are told that our declining position in the world economy is due to, among other factors, a decline in our country's educational system and our research facilities. Japan produces more engineers and scientists per capita than the United States. Both Japan and West Germany spend more of their gross national product on civilian research than the United States. It is said that in order for us to be able to compete effectively with economic leaders such as Japan and West Germany, our society must place more emphasis on educating our children, and must make a bigger commitment to research.

However, it is difficult to ask Americans to make such commitments when we on Capitol Hill have taken steps to devalue such important functions as education and research. Instead of encouraging more students to continue their education, we cut back on Federal assistance to higher education, we eliminated the deductibility of

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interest paid on student loans, and we tax some student scholarships and fellowships. Instead of working with higher education and industry to develop a joint government-education-industry partnership to get America back on its feet, we raise business taxes, increase the cost of capital, limit incentives for private individuals to make gifts to colleges and universities, and increase the costs of research activities conducted on the campuses of our major private research colleges and universities.

The bill introduced today certainly doesn't address all of these pressing issues, but it would solve one problem. This bill says that private colleges and universities, as well as other charitable institutions, will be able to seek sorely-needed financing.

In order for colleges and universities to continue to carry out their mission, they need to have access to resources sufficient to fulfill their needs. Tuition cannot be expected to pick up the slack, even though the average tuition almost doubled in the 1980s. Indeed, the magnitude of the problem is such that even if tuition doubled again, the unmet facilities' needs could not be funded. Instead, colleges and universities, need to be able to turn to the bond market to fund their essential projects. Unfortunately, many premier research institutions are now or will soon be at the $150 million cap. Many millions are needed to fund these schools' pressing capital needs over the next three to five years. These needs include more research space, library expansion, and rehabilitation of existing structures. Without this bill, colleges and universities will make increased interest payments instead of improving facilities and holding the line on tuition. Let's help our colleges and universities educate our children, not discourage these institutions.

Listen to the words of D. Allan Bromley, Director of the Office of Science and Technology Policy, Executive Office of the President, testifying in front of the Senate Commerce Committee on July 21, 1989:

> A healthy and productive national economy is fundamental to all else that we do. Increasingly it is our know-how that constitutes our edge in an increasingly competitive global market. But to respond successfully to growing pressure from international competitors, we must continue to innovate at a rapid rate. That in turn means both continued investment in research and development, by both the federal and private sectors, and the development of policies and mechanisms to insure the rapid application of research discoveries and the maintenance of a healthy science base. We are unique among the developed nations, for example, in the demands that our private sector make upon our colleges and universities both for new fundamental knowledge and for the young minds trained to use it creatively. But after more than a decade of belt tightening, when even more than ever before is being demanded of them, these institutions find themselves with decaying infrastructures, obsolete equipment and growing shortages of both faculty and students in many important areas. These are problems that we can only ignore at our peril.

In its most recent survey of science and energy research facilities at the nation's colleges and universities, the National Science Foundation (NSF) reports some alarming developments. The deferral of needed construction of science and engineering facilities at colleges and universities continues to grow; the current $12 billion of deferred capital projects represents a 40 percent increase over the level found by the NSF in 1988. The NSF found that for every dollar that will be spent for new facilities construction in 1990-91, $3.11 of needed construction will be deferred. By the end of 1991, the amount of deferred repair and renovation of research facilities will have increased by $4 billion, resulting in the deferral of $4.25 for every dollar spent for these purposes.

It is not getting easier to make up these deferred costs. Federal, state, and local safety and regulatory requirements (such as animal care facilities, toxic and hazardous waste storage and disposal facilities) as well as the needs for more sophisticated and costly systems add, not reduce, the costs of these facilities. The NSF survey shows that the costs of research facilities has increased by more than one-third since limitations were placed on tax-exempt bond financings for colleges and universities, from $207 per square feet in 1986-87 to $311 per square feet in 1990-91.

There can be no doubt but that limiting tax-exempt debt for private institutions is affecting their capacity to conduct needed research for the nation. Nearly two-thirds (19) of the 30 independent universities that are among the 100 largest research performers in the nation have already reached the $150 million maximum borrowing limit. In contrast to the privately funded and supported colleges and universities, their public counterparts received almost half of all funds spent on facilities from state or local governments. Private colleges and universities, undertaking the same activities, must rely on private gifts—which are also negatively affected by other changes make in the Tax Reform Act—or more expensive forms of borrowings.

In 1989, Coopers & Lybrand's report "The Decaying American Campus," confirmed the NSF findings. Of the estimated $60 billion needed to renew and replace aging facilities, more than $7.2 billion represent urgent needs of research universities. Thus, the longer we wait to help these vital institutions, the more troubling and enormous the problem will become. Already, one-third of higher education's physical plants are at least 30 years old. Let me emphasize again that this problem is not solely these institutions' problem; it is our Nation's problem.

Leaders of public colleges and universities, that would not directly benefit from this legislation, endorse the idea of extending this proposed benefit to their private counterparts. Robert L. Clodius, president of the National Association of State Universities and Land Grant Colleges has said that ". . . the cap on private universities merely increases the cost of research at U.S. institutions and must be removed if the United States is to retain its world leadership role." Dr. Hans Mark, chancellor of the University of Texas System, testifying in front of the Subcommittee on Taxation and Debt Management of the Committee on Finance on April 3, 1987, stated that ". . . in recent years, the tax exempt securities market has become an important source of funds for building new laboratories." He went on to state that the $150 million tax cap ". . . will affect many of our nations' foremost research universities, and for that reason we should all be concerned." Although Dr. Mark was testifying with respect to eliminating the cap for research facilities, his concern was based on the recognition that basic research undertaken by our colleges and universities, regardless of whether they are public or private institutions, is essential to maintaining our Nation's leadership position in a world of rapidly expanding technological capabilities. This bill would provide support for this critical activity, by allowing private colleges and universities to further all of their educational objectives more easily.

Others share this view that increased support of higher education will help solve our competitiveness problem. In 1986, the White House Science Council Panel on the Health of U. S. Colleges and Universities submitted its report, "A Renewed Partnership," to the President of the United States. This report emphasizes that increased Federal support of research conducted by our Nation's universities is critical to the health of our economy. The report states:

> We are certainly not alone in recognizing that science and technology are critical to our force. Nations everywhere are investing in these capabilities. We conclude that we must rethink and, in many ways, rebuild the critically important interaction between universities, government, and industry that has served this Nation so well in the past. The federal government-university relationship is too fundamental to the maintenance of our national science and technology base to be taken for granted, and the industry-university partnership is emerging as critical to exploiting that base in order to compete in the world marketplace.
>
> One conclusion is clear: our universities today simply cannot respond to society's expectations for them or discharge their national responsibilities in research and education without substantially increased support.
>
> The strength of the nation in trade, defense, and health has been directly related to past investments in science and technology. Our future position in global markets will similarly depend on our willingness to respond to opportunity and to mobilize our strengths today. To this end, we must promote a broad interdisciplinary approach to problem-solving by focusing on university-based centers that will improve cooperative linkages between scientists, engineers, and industry.

This bill addresses only one of the issues that needs to be dealt with as we work to regain our competitive edge in the world, but I believe that it deals with an important issue in a positive, constructive manner.

Mr. Chairman, I join with my distinguished colleague from New York in urging the Senate to act quickly to pass S. 150.

PREPARED STATEMENT OF SENATOR CRISTOPHER J. DODD

Chariman Boren and members of the Taxation Subcommittee, thank you for giving me the opportunity to testify on S. 913, "The Tax Exempt Bond Simplification Act of 1991." this is legislation I cosponsored with Senator Baucus, together with the distinguished chairman of this subcommittee and Senator Riegle. We introduced the bill April 24th.

This legislation is designed to provide relief for State and local governments now struggling to comply with the burdensome and expensive requirements of the Tax Reform Act of 1986. Passage of this bill will lower their cost of issuing bonds, and taxpayer funds now spent on lawyers and consultants will be redirected to pay for the infrastructure and other needs of our cities and states.

The Banking Committee's Subcommittee on Securities, which I chair, has held two hearings on the issue of "State and Local Governments Under Stress: The Role of the Capital Markets." The Securities Subcommittee has jurisdiction over the SEC, Securities Brokers and Dealers, and transactions in the Securities Markets. Our broad responsibility is to protect investors and ensure that investors have confidence in the markets—not just the market for corporate securities but the market for municipal securities as well. During our hearings, I have questioned many experts about the safety of the municipal bond market, and I have urged the SEC to be especially vigilant in its oversight of this market, during a time when we see increasing numbers of downgradings and defaults.

I also hoped our hearings would help us find a means to assist State and local governments in their efforts to raise funds through the capital markets. It was clear to me that, after more than a decade of reduced Federal commitment to cities, and with the recession producing lower and lower tax receipts for State and local budgets, our cities and States must have the ability to raise low cost funds in the bond market.

At the outset, I had no intention of holding hearings on tax issues. But I found that there is very little we can do through amendments to the Federal securities laws to enhance the ability of State and local governments to issue municipal bonds. As we continued the hearings, and as I talked with officials in my State and around the country, it became clear that state and local governments were under very serious burdens as a result of the 1986 tax reform act. That jurisdiction rests with this committee, and I am here this morning to share with you some of the information we developed through hearings in the Securities Subcommittee.

Our hearings produced dramatic testimony about the magnitude of the problems facing State and local governments. Today, I am submitting the reports of the National Governors' Association, the National League of Cities, and the U.S. Conference of Mayors, which were presented to the subcommittee. Please feel free to read them and include the reports or any portion of the reports in your record.

The National Governors' Association report states that, from Connecticut to California, "State fiscal conditions in 1991 are the worst in nearly a decade. The most important single indicator of State fiscal health—total balances—has fallen to a level of $5.9 billion, or just two percent of expenditures." If you leave out Alaska, State balances are about 1.5% of expenditures. That is less than one third of what they were just two years ago.

The governors' report shows that twenty-nine States have reduced their fiscal 1991 budgets by $8 billion. Proposed State tax and other revenue increases for fiscal 1992 now total $6.6 billion and are likely to grow if the recession persists. More tax increases and budget cuts will be necessary for many states just to keep their heads above water. We can forget about funding new bridges, new roads, or new schools.

I know there are some who say we are moving out of this recession. I hope, but I am not convinced, that they are right. The dramatic budget cuts and tax increases that are occurring in state after state, at best will be a serious drag on any recovery. At worse, they may push us deeper into the recession. We are walking a very perilous path.

And, what about the cities? It is clear that our States are in no position to help our cities. And we are seeing the results of more than a decade of retreat from our cities by the Federal Government as well. A survey of 50 cities by the U.S. Conference of Mayors showed that Federal funds as a percentage of city budgets averaged 17.7 percent in 1980, but only 6.4 percent of city budgets last year.

The report of the National League of Cities shows the devastating implications of that Federal retreat. Our central cities are fast becoming the homes of only those who are left there. The most disturbing statistics in the report show the growing disparity in per capita income between central cities and their suburbs.

—in 1960, per capita income of cities was 105% of the per capital income of their suburbs.
—in 1980, the ratio was 89%.
—by 1987, per capita income in central cities was only 59% of that of their suburbs.

I would emphasize that these are 1987 numbers—we do not have 1990 numbers yet. These numbers, therefore, do not show the effects of the recession. They *do*

show a 27-year trend, in which the last 10 years are almost a straight line downward. It is no wonder that our cities are impoverished; that their tax bases are declining. In some cities, unemployment is almost double the rate of the surrounding suburbs.

As a Senator from Connecticut, I have a special interest in these issues. If you leave out Alaska, my State is probably the richest State, per capita, in the country. Yet the cities of Hartford, New Haven, and Bridgeport in 1990 were the fourth, seventh, and ninth poorest cities in the Nation. That's before the effects of a recession. And today, my State is grappling with the twin effects of a recession and a credit crunch. It's strapped for funds, and it is in no position to help our cities.

Over the past week, Connecticut State officials have been struggling with the problems of Bridgeport. For those who think it cannot happen in your state or in your for cities, I would say, Bridgeport is only today's headlines. Look around you. From New York City, to Philadelphia, to New Orleans, to Los Angeles, the crisis in our cities is a national crisis, and one that demands a national solution.

What can we do about it? At the subcommittee's hearings, virtually all of the public and private sector witnesses talked about the adverse and unforeseen effects of the 1986 Tax Reform Act on State and local finance. It clearly went too far.

Connecticut State Treasurer Frank Borges testified that, as a result of the "multiple hoops imposed by the tax reform act of 1986 . . . . our direct costs of issuance of tax-exempt bonds have *quadrupled.*"

Just three weeks ago, officials from the Connecticut treasurer's office came to Washington to talk with the Internal Revenue Service about newly proposed regulations and their impact on the state. They were accompanied by lawyers from three separate law firms. I am told by Connecticut treasury officials that, before passage of the 1986 Act, bond counsel fees for a $150 million issue would be about $50,000, and the documents were about one-half inch thick today, bond counsel fees for an issue that size range from $250,000 to $350,000, and the documents are three to four inches thick. It my view, that's absurd. while I appreciate the hard work of the Connecticut legal community, I believe taxpayer funds spent on lawyers could be better spent on the educational and infrastructure needs of my State.

Mayor Bolen of Fort Worth, Texas, who testified before the subcommittee on behalf of the National League of Cities, told us, "the arbitrage and rebate requirements alone have diverted hundreds of millions of dollars out of public reinvestment into consultants, advisers and others whose sole purpose is to attempt to reduce the amount of money which eventually must be rebated to the U.S. Treasury."

Today we face a more volatile market and much greater costs in issuing debt. At the same time, State and local governments must place greater reliance upon debt than ever before to meet their capital needs.

Mr. Chairman, S. 913 will not solve the for problems facing our State and local governments today. But it is a much needed first step in facilitating the means for state and local governments to help themselves.

I know it will cost money. Let me say that the revenue estimate by the joint committee is on the high side. For example, there is reason to believe permitting municipal issuers to keep 10% of arbitrage earnings will not cost us revenues, and may, in fact, bring in revenues. We will try to develop that information for you.

Overall, I would suggest that the savings to States will be ear greater than any Federal revenue loss—simply because their cost of compliance will be lower.

I believe that when my colleagues have had an opportunity to talk with their own State and local officials and make their own assessments of the need for this measure, it will receive broad, bipartisan support. Let me thank you again for the opportunity to testify on this very busy morning. Let me also thank my colleague, Senator Baucus, for his leadership on this issue, as well as for letting me join him in sponsoring the legislation. I look forward to seeing the legislation adopted in this Congress.

THE STATES

"Fiscal Survey of the States," National Governors Association and National Association of State Budget Officers, April 1991

The report by the National Governors' Association states, "state fiscal conditions in 1991—the worst in nearly a decade. The most important single indicator of state fiscal health—total balances—has fallen to a level of $5.9 billion, or just 2.0% of expenditures." The report notes that, excluding a large surplus in Alaska, balances are estimated at just 1.5% of expenditures." This compares to 1989, when state balances totaled $12.5 billion and represented 4.8% of total state general fund expenditures.

These balances are important, because they measure the amount of resources states have available to use if the condition of the economy declines. The report observes, "Only six months into this recession, states are at nearly the same level of distress as they were after more than a year of recession in fiscal 1983 . . . . If the recession persists well into fiscal 1992, the levels of state budget cuts, tax increases, and balances are likely to be far worn than they are now estimated to be." For most states, fiscal 1992 begins July, 1991.

Other major findings of the report include:

• Reflecting the extreme difficulties states face, twenty-nine states have reduced fiscal 1991 budgets by $8 billion.

• Proposed state tax and other revenue increases for fiscal 1992 total $6.6 billion. If the recession persists, this amount is likely to grow.

• Governors' fiscal 1992 budgets contain growth of just 4.8 percent. This is the lowest rate of growth since 1983 and represents a reduction of services in many states.

• The three major state tax sources—personal income taxes, sales taxes, and corporate income taxes—are performing below expectation for may states. Corporate income tax continues to be the weakest, with 31 of 46 states reporting collections below estimates.

• Federal increases in cigarette, alcohol, and gasoline taxes have reduced state tax activity in these areas.

• The eastern U.S. is in worn condition than the western U.S., and northeastern states continue to face the most severe budget crises.

• Medicaid, which grew by more than 18 percent in fiscal 1990, is consuming more resources than current state taxes * * *

* * * * * * *

THE CITIES

"Research Report on America's Cities: City Fiscal Distress," National League of Cities, March, 1991

While the problems of New York City, Philadelphia, and Bridgeport have reached crisis proportions, a recent report by the National League of Cities shows that the problems affecting these and other cities stem from converging patterns of economic, social and intergovernmental change. The report notes, "it is these deeper patterns, rather than short-term political or management behavior that dominates headlines, that require the attention of policy-makers at all levels."

The major patterns include:

• The U.S. is undergoing a major industrial restructuring. For the central cities in particular, the consequence of this process of economic change is steady erosion of their tax bases, concurrent with increasing joblessness.

• Most startling is the growing disparity in per capita income between central cities and suburbs. In 1960, per capita income of cities was 105% that of their suburbs; by 1880, the ratio was 89%; and by 1987, per capita income in central cities was only 59% of that of their suburbs.

• There are significant differences in rates of unemployment between almost all cities and their suburbs. In a few, such as Detroit, Baltimore and St. Louis, central city unemployment rates are almost double those experienced of their suburbs.

• Major demographic shifts have combined with structural economic change to erode the tax bases of central cities. More than 5.5 million more people lived in poverty at the end of the decade of the 1980s than ten years previously, and, during this period, poverty became increasingly concentrated in the nation's central cities.

• Federal cutbacks and fiscal retrenchment in many states have scantly reduced the share of local revenues provided by the Federal Government and states. At the same time, the escalating costs of federal and state mandated programs are placing growing fiscal burdens on cities. some states impoverish their cities by tightly regulating types and rates of taxes cities can use.

City Fiscal Conditions 1980-1990

A 50-CITY SURVEY
January 1991

THE UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, N.W.
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THE UNITED STATES CONFERENCE OF MAYORS

The Honorable Robert M. Isaac, President
Mayor of Colorado Springs

J. Thomas Cochran
Executive Director

This report was written by Lance Simmens, Assistant Executive Director, The U.S. Conference of Mayors and Daniel Schwartz, whose assistance in preparing the report was invaluable.

Additional copies of the report are available for $10 each from the Office of Public Affairs, The U.S. Conference of Mayors, 1620 Eye Street, N.W., Washington, D.C. 20006, (202) 293-7330

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Executive Director
J. THOMAS COCHRAN

January 1991

Dear Mayor:

The following report was compiled from responses of 50 cities to a survey questionnaire sent to them last November. The United States Conference of Mayors was directed to undertake the survey by its Executive Committee at a meeting held in Colorado Springs, Colorado in September.

Over the past decade Mayors have testified before Congress, sent letters and telegrams to Congress and the Administration, and placed phone calls to Federal officials apprising them of the financial difficulties facing cities in light of drastic federal funding cutbacks, emerging physical and social infrastructure problems, and a plethora of unfunded federal and state mandates.

A massive effort was mounted to protect General Revenue Sharing, the most efficient, cost-effective, federal program to aid cities ever devised. However, our efforts failed. This study documents what has happened in the era of "fend-for-yourself" federalism and what cities have been doing to responsibly deal with federal disinvestment.

The cities covered in this survey span the spectrum in terms of size and geographical location. What it shows is simply this: while the federal government's contributions to cities has been declining dramatically, states have stepped in to fill a small fraction of the gap, cities have used an assortment of traditional and innovative measures to fill the gap, but the growing problems facing cities are overwhelming.

If the federal government can rescue mismanaged and corrupt financial institutions it certainly can expend just a fraction of that amount on the crisis facing American cities. Just as we can find resources to protect our troops abroad, we must find resources to protect our citizens at home.

Sincerely,

Tom Cochran

J. Thomas Cochran
Executive Director

EXECUTIVE SUMMARY

This report summarizes responses by 50 cities on the fiscal trends over the past ten years in view of the shifting sands of federalism brought about by the Reagan Revolution. Chronic budget deficits and the accompanying budgetary austerity combined with a deliberate shift in budget priorities away from domestic discretionary spending which Congress and the Administration approved over the past decade have produced the following:

- federal funds as a percentage of city budgets was reduced by over 64 percent from an average of 17.7 percent in 1980 to an average of 6.4 percent in 1990.
- cities have moved to fill this gap, increasing their percentage of city budgets from 64.7 percent in 1980 to 75.0 percent in 1990.
- states have moved to fill the gap but only marginally so, increasing their average contributions from 11.1 percent in 1960 to 12.2 percent in 1990.
- at the same time, city budgets have increased by 95.5 percent to deal with increasing problems.
- to deal with the resulting financial shortfalls, 72 percent of those cities responding elected to raise taxes, 42 percent raised taxes and cut services, and 32 percent raised taxes, cut services, reduced city workers, and raised revenues through various other measures.
- 56 percent of those responding indicated that they had raised taxes in the last year.
- to compound these trends, unfunded federal and state mandates have had tremendous cost impacts upon cities: environmental and labor issues lead the list.
- public safety, economic development, infrastructure, public finance, and community/neighborhood development issues were among the top five priorities facing cities in 1990.

CHAPTER I

PLEASE INDICATE BELOW HOW MUCH MONEY EACH LEVEL OF GOVERNMENT PROVIDED IN REVENUES TO YOUR CITY'S BUDGET IN 1980 AND 1990.

Of the fifty cities surveyed, federal funds as a percentage of city budgets averaged 17.7 percent in 1980 and only 6.4 percent of city budgets in 1990. This represents a 63.8 percent reduction in federal effort over the decade. This occurred at a time when city budgets increased an average of 95.5 percent to cope with ever-growing social service demands and inflation. When adjusted for inflation, city budgets grew by 22.4 percent in real terms during the 1980-1990 period. Thus, while city budgets were growing in both nominal and real terms, the federal government's contribution was contracting by nearly 64 percent.

To help fill this gap, city contributions were increasing from an average of 64.7 percent in 1980 to 75.0 percent in 1990. This represents an increase of 15.9 percent. At the same time, state government contributions grew from an average of 11.1 percent of city budgets to 12.2 percent, an increase of 9.9 percent. Hence, while city budgets were increasing and federal contributions were being reduced dramatically, both city and state governments stepped in to try to fill the resulting gap, with cities increasing their percentage contributions by nearly 70 percent more than corresponding state percentage contributions.

TABLE I

Revenue Source	1980% of Total City Revenue	1990% of Total City Revenue	%Change in Fund
Federal Government	17.7	6.4	-63.8
State Government	11.1	12.2	+ 9.9
City Government	64.7	75.0	+15.9

Table I represents the consolidated averages of percentage contributions of the fifty cities surveyed. Table II represents a breakdown of the fifty individual cities and their respective percentage contributions.

Table III shows the nominal percentage change in city budgets over the decade, not accounting for inflation in Column I as well as the real percentage change in city budgets adjusted for inflation in column 2.

TABLE II

PERCENTAGE OF GOVERNMENTAL CONTRIBUTIONS
TO CITY BUDGETS
1980-1990 BY CITY

	FEDERAL			STATE			CITY			OTHER		
	1980	1990	80/90 % CHGE	1980	1990	80/90 %CHGE	1980	1990	80/90 %CHGE	1980	1990	80/90 %CHGE
Akron	31.6	20.4	-35.4	6.5	5.9	- 9.2	61.9	73.5	+18.7	0	0.3	-
Albany	13.7	1.5	-89.1	20.1	12.8	-36.3	66.2	85.8	+29.6	-	-	-
Alexandria	10.1	3.8	-62.4	13.5	17.3	+28.1	76.4	76.5	+ 0.1	-	-	-
Allentown	10.6	6.8	-35.8	2.8	3.2	+14.3	85.9	89.4	+ 4.1	0.6	0.6	0
Baltimore	29.9	15.0	-49.8	38.2	33.8	-11.5	29.6	48.2	+62.8	0.5	1.7	+240
Binghamton	28.9	6.6	-77.2	4.6	13.1	+176.6	49.5	67.3	+36.0	17.0	13.2	-22.4
Birmingham	13.5	4.5	-65.2	0.4	1.7	+325	82.4	91.1	+ 8.0	2.3	2.8	21.7
Boise	28.0	8.8	-68.8	4.4	7.0	+59.1	67.5	84.2	+24.7	0	0	0
Boston	14.6	4.5	-69.2	21.1	30.6	+45.0	63.4	64.6	+ 1.9	0.9	0.2	-77.8
Charlotte	18.8	6.5	-65.4	2.3	3.3	+43.5	56.2	87.3	+55.3	22.7	3.0	-86.8
Cheyenne	20.4	1.4	-93.1	22.8	35.1	+53.9	39.1	36.0	-7.9	19.4	27.5	+41.8
Chicago	29.6	11.7	-60.5	18.5	16.4	-11.4	51.9	71.8	+38.3	0	0.2	-
Colorado Spg	7.5	0.9	-88.0	4.5	7.2	+60.0	87.8	88.2	+ 0.5	0.2	3.8	+1800
Cranston	24.1	4.7	-80.5	13.7	19.7	+43.8	62.1	75.6	+21.7	-	-	-
Decatur	18.0	5.5	-69.4	10.6	14.1	+33.0	70.5	80.0	+13.5	0.7	0.4	-37.7
Detroit	22.9	11.7	-48.8	17.0	25.1	+47.3	60.8	63.0	+3.6	-	-	-
Evanston	1.3	0.4	-69.2	0.7	0.6	-14.3	97.7	99.0	+ 1.3	0.2	0.4	+100
Galveston	18.6	3.9	-79.0	0.4	5.4	+1250	80.9	90.6	+12.0	0.1	-	-100
Glendale	9.2	6.6	-28.3	16.4	27.2	+65.9	74.4	62.1	-12.3	-	4.1	0
Houston	0.09	.03	-66.0	0.6	0.03	-95.0	99.1	97.9	- 1.2	0.1	1.4	+1300
Indianapolis	43.8	9.0	-79.5	6.8	9.2	+35.3	49.4	81.6	+65.2	0	0.2	-
Irvine	2.0	1.3	-35.0	7.7	10.1	+31.2	79.1	88.1	+11.4	11.1	0.5	-95.5
Jackson	28.5	10.0	64.9	23.6	29.0	+22.9	29.2	41.3	+41.4	18.7	19.8	+ 5.9
Jacksonville	24.2	10.8	-55.4	6.2	7.7	+24.2	69.1	81.0	+17.2	0.5	0.5	0
Kansas City	21.1	9.3	-55.9	3.7	3.3	-10.8	75.2	86.2	+14.6	0	1.2	-
Los Angeles	10.6	3.6	-66.0	10.4	6.1	-41.3	78.5	88.7	+13 0	0.5	1.6	+220.0
Louisville	22.9	14.5	-36.7	3.2	4.8	+50.0	41.9	57.3	+36.8	32.0	23.3	- 27.2

	FEDERAL			STATE			CITY			OTHER		
	1980	1990	80/90 % CHGE	1980	1990	80/90 %CHGE	1980	1990	80/90 %CHGE	1980	1990	80/90 %CHGE
Madison	4.1	7.1	+73.2	43.4	26.7	-38.0	52.4	66.1	+26.1	0.1	0.05	-50.0
Meridian	40.5	5.3	-86.9	1.5	1.2	-20.0	58.0	93.6	+61.4	-	-	-
Mesa	6.6	3.0	-54.5	14.7	24.2	+64.6	78.5	72.8	- 7.3	0.2	0.04	-80.0
Newark, CA	18.0	.03	-99.8	2.2	2.1	- 4.5	73.6	97.3	+32.2	6.3	.006	-99.9
Newark, NJ	19.7	2.7	-86.2	27.5	23.9	-13.1	33.9	49.2	+45.1	19.0	23.9	+25.8
North Miami	4.5	.02	-99.5	7.7	9.3	+20.8	86.9	88.4	+ 1.7	0.9	2.3	+155.5
Oak Park	2.9	1.1	-62.1	17.8	18.5	+ 3.9	79.2	80.0	+0.01	0.02	0.4	+1900
Ogden	25.1	7.7	-69.3	4.8	5.1	+ 6.3	68.8	84.8	+23.3	0.2	2.3	+2100
Pasadena	21.5	9.5	-55.8	13.8	8.3	-39.9	58.7	73.6	+25.4	6.0	9.3	+55.0
Phoenix	20.6	6.7	-67.5	20.3	23.2	+14.3	59.1	70.1	+18.6	-	-	-
Pocatello	7.3	4.8	-34.2	4.6	6.2	+34.8	82.8	86.3	+ 4.2	5.3	2.7	-49.1
Portland	19.3	2.4	-87.6	4.2	3.8	- 9.5	75.5	89.6	+18.7	1.0	4.1	+31.0
Rochester	31.5	15.3	-51.4	16.2	14.0	-13.6	51.7	68.8	+33.1	0.5	2.0	+300
San Diego	7.4	0.8	-89.1	8.4	3.0	-64.3	84.2	91.2	+ 8.3	-	-	-
Sandy City	11.1	1.3	-88.3	6.0	5.4	-10.0	82.9	93.4	+12.7	-	-	-
Sarasota	5.5	2.7	-50.9	7.0	17.8	+154.3	38.0	29.3	-22.9	49.6	50.2	+ 1.2
Savannah	27.7	3.9	-85.9	1.9	0.07	-96.3	68.7	94.8	+38.0	1.7	0.06	-96.5
St. Paul	21.6	8.1	-62.5	28.2	31.8	+12.8	45.0	58.1	+29.1	5.1	1.4	-72.5
St.Petersburg	4.0	0.3	-92.5	11.0	8.1	-26.4	84.3	89.6	+ 6.3	0.7	2.1	+200
Topeka	20.8	1.7	-91.8	5.6	8.6	+53.6	71.5	88.6	+23.9	2.0	1.1	-45.0
Williamsport	15.3	35.1	+129	9.9	5.9	-40.4	63.6	49.9	-21.5	1.2	9.2	-17.0
Winston-Salem	20.0	2.3	-88.5	12.8	9.0	-29.7	23.1	20.3	-12.0	43.9	68.5	+56.0
York	23.3	5.8	-75.1	5.8	3.1	-46.6	69.6	90.5	+30.0	-	-	-

TABLE III

CITY	NOMINAL % CHANGE BETWEEN 1980 & 1990 CITY BUDGET	REAL % CHANGE BETWEEN 1980 & 1990 CITY BUDGET
Akron	41.3	- 11.7
Albany	100.6	+ 25.4
Alexandria	135.8	+ 47.4
Allentown	55.2	- 3.0
Baltimore	17.0	- 26.9
Binghamton	101.1	+ 25.7
Birmingham	35.7	- 15.2
Boise	116.7	+ 35.4
Boston	61.1	+ 0.7
Charlotte	105.1	+ 28.2
Cheyenne	58.7	+ 0.8
Chicago	114.2	+ 36.7
Colorado Spgs.	106.9	+ 29.3
Cranston	68.2	+ 5.1
Decatur	62.1	+ 1.3
Detroit	27.1	- 20.5
Evanston	124.8	+ 40.2
Galveston	58.6	- 1.0
Glendale	204.4	+ 90.3
Houston	67.3	+ 4.6
Indianapolis	60.9	+ .5
Irvine	218.6	+ 99.1
Jackson	38.5	- 13.4
Jacksonville	56.6	- 2.1
Kansas City	59.1	- .6
Los Angeles	195.7	+ 84.8
Louisville	34.4	- 16.0
Madison	53.4	- 4.1
Meridian	4.6	- 34.6
Mesa	208.8	+ 93.0
Newark, CA	167.9	+ 67.4
Newark, NJ	70.5	+ 6.6
North Miami	72.2	+ 7.6
Oak Park	71.1	+ 7.0
Ogden	41.7	- 11.5
Pasadena	131.4	+ 44.6
Phoenix	158.8	+ 61.7
Pocatello	98.3	+ 23.6
Portland	100.5	+ 25.3
Rochester	52.9	- 4.4
San Diego	189.1	+ 80.7
Sandy City	187.8	+ 79.9
Sarasota	198.3	+ 86.5
Savannah	174.4	+ 71.4
St. Paul	78.9	+ 11.8
St. Petersburg	129.4	+ 43.4
Topeka	89.8	+ 18.6
Williamsport	-18.6	- 49.1
Winston-Salem	118.6	- 36.5
York	70.5	+ 6.5
TOTAL	+95.5	+22.4

CHAPTER II

IF YOUR CITY'S FEDERAL OR STATE REVENUES HAVE DECLINED, HOW HAVE YOU MADE UP THE DIFFERENCE?

When asked how they dealt with the fiscal shortfalls during the 1980-1990 period, cities were asked whether they raised taxes, cut services, and/or reduced the number of city employees. Twenty-four cities or 48 percent of those responding indicated that they cut services. Thirty-six cities or 72 percent of those responding indicated that they raised taxes, and thirty-four cities or 68 percent of those responding indicated that they reduced the number of city employees.

Table IV lists the cities responding and the option(s) they exercised in making up the corresponding fiscal shortfalls. Column 4 includes other sources of revenue-raising measures undertaken by cities, most notably increasing or implementing user fees.

Table IV shows that of those cities responding to the survey, twenty-one, or 42 percent, both raised taxes and cut services. This table also shows that sixteen cities or 32 percent raised taxes, cut services, reduced city employees and raised revenues through other revenue measures.

Table V documents the list of options mentioned under other revenue sources. Table V shows the other revenue sources listed to counteract the fiscal shortfalls experienced by cities over the past decade. As can be seen from Table V, 20 cities or 40% of those responding, reported that they increased user fees. Other categories in which responses were made are listed as well in Table V.

OPTIONS EMPLOYED BY CITIES TO RESPOND TO FISCAL SHORTFALLS

TABLE IV

	CUT SERVICES	RAISED TAXES	REDUCED CITY EMP.	OTHER
Akron	x	x	x	x
Albany				x
Alexandria				x
Allentown	x	x	x	x
Baltimore	x	x	x	x
Binghamton		x	x	
Birmingham		x		x
Boise				x
Boston				x
Charlotte				x
Cheyenne			x	x
Chicago		x	x	x
Colorado Spgs.				x
Cranston		x	x	x
Decatur				x
Detroit	x	x	x	x
Evanston		x	x	x
Galveston		x	x	x
Glendale	x	x	x	x
Houston	x	x	x	x
Indianapolis		x	x	x
Irvine		x		x
Jackson	x	x	x	x
Jacksonville	x	x	x	x
Kansas City		x	x	x
Los Angeles		x		x
Louisville			x	x
Madison	x	x		
Meridian		x	x	x
Mesa	x	x	x	x
Newark, NJ	x	x	x	
Newark, CA	x	x	x	
No. Miami				x
Oak Park			x	
Ogden	x		x	
Pasadena		x		x
Phoenix	x	x	x	x
Pocatello	x	x	x	x
Portland	x		x	x
Rochester	x	x	x	
San Diego	x	x		x
Sandy City	x		x	
Sarsota	x	x	x	x
Savannah		x	x	x
St. Petersburg	x	x	x	x
St. Paul	x	x		x
Topeka		x	x	
Williamsport		x		
Winston-Salem	x	x	x	x
York	x	x	x	x

TABLE V

TYPES OF OTHER REVENUE SOURCES

User Fees

Akron, OH	Fees
Baltimore, MD	Expand license fee base and new service charges
Charlotte, NC	User fees
Chicago, IL	Increased fees for services
Cranston, RI	User fees and impact fees
Decatur, IL	Increased user fees
Glendale, AZ	User Fee (garbage)
Houston, TX	Zoo admission fee, fire inspection permit fee, increased ambulance fees, library fines and miscellaneous library charges
Jackson, MS	Increased existing fees and established new user fees
Los Angeles, CA	Raised fees
Louisville, KY	Increased insurance premium tax rate
Madison, WI	Ambulance fees
Meridian, MS	Increased fees
Mesa, AZ	User fees
N. Miami, FL	New fees
Phoenix, AZ	Increased emphasis on user fee cost recovery
Sarasota, FL	Increased fees for services
St. Paul, MN	Fees
St. Petersburg,FL	Other user fees
Winston-Salem, NC	Increased user fees

Utility

Chicago, IL	Gas utility tax
Irvine, CA	Utility user tax
Pasadena, CA	Utility users fee and utility contribution
Pocatello, ID	Street utility fee
Portland, OR	Raised utility license fee 3-5 percent investor owned

Gas

Chicago, IL	Vehicle fuel tax
Glendale, AZ	State gas tax
Sarasota, FL	Gas

TABLE V (cont'd)

<u>Sales</u>

Charlotte, NC	Sales tax
Chicago, IL	Sales tax
Decatur, IL	Implemented Sales Tax
Kansas City, MO	Sales tax for capital improvements
Sarasota, FL	Local option sales tax

<u>Hotel/Motel</u>

Glendale, AZ	Hotel tax
Decatur, IL	Hotel/Motel tax

<u>Capital</u>

Galveston, TX	Found alternative funding to capital projects
Meridian, MS	Sold bonds for capital items

<u>General Fund/General Revenue</u>

Charlotte, NC	General Fund
Jacksonville, FL	General Fund/ General Revenues
Meridian, MS	Used Fund Balance

<u>Improved Government Efficiency Measures</u>

Alexandria, VA	New commercial growth in city expanded city's real property tax base
Allentown, PA	Citizens contributions
Baltimore, MD	Transferred operation to state
Baltimore, MD	Privatized
Baltimore, MD	Consolidated certain city operations
Baltimore, MD	Received new state aid
Colorado Spgs. CO	Federal decline offset by state increase
Decatur, IL	State income-tax
Evanston, IL	Development of research park in cooperation with university to expand tax base
Louisville, KY	Implemented more cost effective operations
San Diego, CA	Reduction in non-essential services
York, PA	Privatization

<u>Real Estate</u>

Chicago, IL	real property transfer
Evanston, IL	sell properties

TABLE V (cont'd)

Motor Vehicle

Charlotte, NC	Motor Vehicle
Chicago, IL	Parking tax
Chicago, IL	Auto Rental tax

Sin Taxes

Baltimore, MD	Beverage container tax
Chicago, IL	Liquor tax
Chicago, IL	Amusement tax
Chicago, IL	Off-track betting
Chicago, IL	Cigarette tax

TABLE VI

CITIES THAT INCREASED LOCAL TAXES IN THE LAST YEAR

YES	NO
Akron, OH	Albany, NY
Allentown, PA	Alexandria, VA
Baltimore, MD	Birmingham, AL
Binghamton, NY	Charlotte, NC
Boise, ID	Cheyenne, WY
Boston, MA	Chicago, IL
Colorado Springs, CO	Detroit, MI
Cranston, RI	Galveston, TX
Decatur, IL	Glendale, AZ
Evanston, IL	Houston, TX
Jackson, MS	Indianapolis, IN
Jacksonville, FL	Irvine, CA
Kansas City, MO	Louisville, KY
Los Angeles, CA	North Miami, FL
Madison, WI	Oak Park, MI
Meridian, MS	Ogden, UT
Mesa, AZ	Phoenix, AZ
Newark, CA	Portland, OR
Newark, NJ	Sandy City, UT
Pasadena, CA	Topeka, KS
Pocatello, ID	Williamsport, PA
Rochester, NY	York, PA
San Diego, CA	
Sarasota, FL	
Savannah, GA	
St. Petersburg, FL	
St.Paul, MN	
Winston-Salem, NC	

CHAPTER III

HAVE YOU INCREASED LOCAL TAXES IN THE LAST YEAR?

When asked if the city had increased local taxes in the last year twenty-eight, or 56 percent of those responding said that they had while twenty-two, or 44 percent of those responding said that they had not. (Table VI)

Table VII outlines the types of local taxes raised over the past year by those cities responding to the survey.

Additionally, cities were asked whether their local tax rates were at the maximum allowable amount under state law. In response to this question, 26 or 52 percent responded yes, while 22 responded no. The responses to this question are found in Table VIII.

TABLE VII

Advolorem Tax

Jacksonville, FL
Sarasota, FL
St. Petersburg, FL
St. Paul, MN

Earned Income Tax

Allentown, PA

Pension Fund

Jackson, MS	Disability and Relief Pension Fund

Hotel/Motel Tax

Baltimore, MD	Hotel tax
Decatur, IL	Hotel/Motel tax
Los Angeles, CA	Transient Occupancy tax
Mesa, AZ	Transient Occupancy taxes
Newark, CA	Transient Occupancy taxes
Savannah, GA	Special tourism (Hotel/Motel tax)

Property Tax

Akron, OH
Binghamton, NY
Boise, ID
Boston, MA
Newark, NJ
Colorado Spgs. CO
Kansas City, MO
Madison, WI
Pocatello, ID
Rochester, NY
Savannah, GA
St. Paul, MN
Winston-Salem, NC

Fees

Allentown, PA	Garbage fee
Birmingham, AL	Increased fees on items such as permits etc.
Cranston, RI	User fees
Evanston, IL	Long-term care and food inspection fees
Mesa, AZ	Renewal fees for sales tax licenses

TABLE VII (cont'd)

Utility

Allentown, PA	Water and sewage rates
Mesa, AZ	Utility rate
Newark, NJ	Sewer rates

Business

Los Angeles, CA	Business tax
Newark, CA	Business license
San Diego, CA	Business license
Savannah, GA	Business and alcohol license

Parking Tax

Baltimore, MD
Evanston, IL
Los Angeles, CA (Parking user tax)

Other

Evanston, IL	Undertakers tax
Evanston, IL	Admissions amusement and beverage container taxes
Savannah, GA	Cable T.V. tax
Meridian, MS	Debt service
San Diego, CA	Rental unit tax
Kansas City, MO	Cigarette tax

TABLE VIII

ARE YOUR LOCAL TAX RATES AT MAXIMUM ALLOWABLE AMOUNT UNDER STATE LAW?

<u>Yes</u>

Alexandria, VA
Allentown, PA
Baltimore, MD
Binghamton, NY
Boise, ID
Boston, MA
Cheyenne, WY
Chicago, IL
Detroit, MI
Houston, TX
Irvine, CA
Jacksonville, FL
Kansas City, MO
Los Angeles, CA
Meridian, MS
N. Miami, FL
Newark, NJ
Oak Park, MI
Pasadena, CA
Phoenix, AZ
Portland, OR
Sandy City, UT
Savannah, GA
St. Petersburg, FL
St. Paul, MN
Topeka, KS

<u>No</u>

Akron, OH
Albany, NY
Birmingham, AL
Charlotte, NC
Colorado Springs, CO
Cranston, RI
Galveston, TX
Glendale, AZ
Houston, TX
Indianapolis, IN
Jackson, MS
Jacksonville, FL
Madison, WI
Mesa, AZ
Ogden, UT
Pocatello, ID
Rochester, NY
San Diego, CA
Sarasota, FL
Williamsport, PA
Winston-Salem, NC
York, PA

<u>Not Applicable</u>

Decatur, IL
Evanston, IL

CHAPTER IV

IN WHAT AREAS HAVE THE 1986 TAX REFORM ACT RESTRICTIONS ON PRIVATE-ACTIVITY BONDS HAD THE MOST IMPACT ON YOUR CITY?

To compound the loss of federal aid during the 1980's, cities were also faced with federal restrictions on their ability to issue tax-exempt bonds. The Tax Reform Act of 1986 placed restrictions on the issuance of private-activity bonds which has placed hardships on city economic development efforts.

Table IX indicates the types of activities which have been affected by the Tax Reform Act restrictions.

TABLE IX

In what areas have the 1986 Tax Reform Act restrictions on private-activity bonds had the most impact on your city?

<u>Arbitrage</u>

Cranston, RI	Tighter limits on arbitrage
Louisville, KY	Complicated arbitrage rebate reporting requirements
Newark, NJ	Arbitrage rules restricted usage of interest
Allentown, PA	Limitations on amount of arbitrage allowable

<u>Bonds</u>

Cranston, RI	Prohibition of advanced refunding (refinancing of bonds by the proceeds of a new issue prior to the date of outstanding securities are due
St. Petersburg, FL	Cost complexity of accounting bond issues

<u>Economic development</u>

Cheyenne, WY	Economic development
Jackson, MS	Limited some industries', albeit uncertain which ones, ability to expand
Madison, WI	Economic development
San Diego, CA	Economic development
Savannah, GA	Reduced economic development
St. Paul, MN	Hurt older city in competition with suburbs to keep industry, lose built-up industry in need of expansion to suburbs
St. Petersburg, FL	Downtown redevelopment (especially parking garages public/private usage
Williamsport, PA	Substantial increase in economic development in partnership with private sector

<u>Parking Garages</u>

Charlotte, NC	Parking decks
Rochester, NY	Parking garages must be now financed through other means because use to be operated by private companies

TABLE IX (cont'd)

<u>Industrial Revenue Bonds</u>

Glendale, AZ	Some difficulty obtaining IRB funding for industrial downturn residential uses
Louisville, KY	Elimination of IRBs for commercial development

<u>Public Arenas</u>

Charlotte, NC	Football stadium
Charlotte, NC	Convention Center
Phoenix, AZ	Sports Stadium

<u>Other</u>

Binghamton, NY	Increased cost of issuance and loss of legal arbitrative earnings
Birmingham, AL	Inability to earn interest on finds to be used for other projects and restrictions on time of expenditures
Boston, MA	Housing, particularly first time buyers
Louisville, KY	Alternative minimum tax requirements and resultant increasing cost of borrowings
Winston-Salem, NC	Ability to participate in mixed-use projects

CHAPTER V

WHAT ARE THE FIVE FEDERAL MANDATES WHICH HAVE THE GREATEST COST IMPLICATIONS FOR YOUR CITY GOVERNMENT'S BUDGET?

When asked which federal mandates have had the greatest cost implications on the city, clearly thirty-three cities representing 66 percent of those responding to the survey, cited environmental mandates. Included in the environmental category were responses dealing with waste, landfills, sewers, and leaking underground storage tanks. Under the category of labor issues responses on the following issues were included: Fair Labor Standards Act, Americans with Disability Act, Davis-Bacon, Social Security and Medicare mandates, Occupational Safety and Health Administration, and the Job Training Partnership Act. Thirty cities, comprising 60 percent of those responding listed mandates in the area of labor issues as having the greatest cost implications for their cities.

Eleven cities, or 22 percent of those responding, cited public finance restrictions such as arbitrage rebate regulations as having the greatest cost implications for their cities and six cities, or 12 percent, said that Community Development Block Grant reductions and the loss of General Revenue Sharing have had the greatest impact on their cities. Ten cities listed items which have been categorized as others, these include employee compensation and benefits and the 1990 census undercount.

Table X is a list of the federal mandates listed by cities as having the greatest cost implications on the city's budget.

TABLE X

ENVIRONMENTAL / INFRASTRUCTURE

Akron, OH	Solid waste
Akron, OH	Clean Air Act
Akron, OH	Clean Water Act
Alexandria, VA	Environmental regulations
Allentown, PA	Clean Water Act
Allentown, PA	Clean Air Act
Baltimore, MD	Underground storage tanks requirements
Baltimore, MD	Solid Waste - landfill design/construction requirements
Baltimore, MD	Asbestos Removal
Birmingham, AL	Stormwater runoff
Birmingham, AL	Wetlands regulations
Birmingham, AL	Landfill regulation
Birmingham, AL	Underground storage tanks
Boise, ID	Underground storage tanks
Boise, ID	Clean Water Act, NPDES and other requirements
Boise, ID	Clean Air Act - buses and other transportation
Boston, MA	Clean Water Act
Boston, MA	Clean Air Act
Chicago, IL	Water Service regulations - lead pipe connections
Chicago, IL	Combined sewer overflow regulations
Chicago, IL	Clean Air Act
Colorado Spgs. CO	Stormwater discharge
Colorado Spgs. CO	EPA mandates
Cranston, RI	Wastewater
Decatur, IL	Clean Water Act - sludge disposal and effluent standards
Detroit, MI	Clean Air Act of 1990
Glendale, AZ	EPA
Houston, TX	Solid waste management standards
Houston, TX	Stormwater Runoff Standards
Indianapolis, IN	EPA - Air Quality
Indianapolis, IN	EPA water quality
Indianapolis, IN	EPA storm/sewer separation planning
Jackson, MS	Sludge regulations
Jackson, MS	Stormwater
Jackson, MS	Subpart D RCRA (landfill)
Jackson, MS	Safe Drinking Water Act
Jackson, MS	Clean Water Act
Jacksonville, FL	Wastewater
Jacksonville, FL	Clean Air Act
Jacksonville, FL	Landfill clean-up
Jacksonville, FL	Clean Water Act

TABLE X (cont'd)

ENVIRONMENTAL / INFRASTRUCTURE

Kansas City, MO	Air Quality
Kansas City, MO	Hazardous waste disposal
Kansas City, MO	Refuse disposal
Los Angeles, CA	Wastewater program
Los Angeles, CA	Clean Air Act
Los Angeles, CA	Stormwater pollution control
Louisville, KY	Clean Air Act regulations
Meridian, MS	Landfill requirements
Meridian, MS	Water and sewer requirements
Mesa, AZ	Water quality requirements
Mesa, AZ	Other environmental requirements excluding water quality standards
Newark, NJ	Prohibition on Ocean Dumping - sludge disposal
Newark, NJ	RCRA
Newark, NJ	Superfund - disposal and clean-up of hazardous waste
North Miami, FL	EPA legislation
Ogden, UT	Fuel storage tank regulations
Pasadena, CA	EPA
Pasadena, CA	Clean Water Act
Phoenix, AZ	Clean Air Act
Phoenix, AZ	Clean Water Act
Phoenix, AZ	RCRA
Phoenix, AZ	Comprehensive Environmental Response Compensation and Liability Act (CERLLA)
Phoenix,AZ	SDWA
San Diego, CA	Clean Water Act
San Diego, CA	EPA's Clean Water Mandate
Savannah, GA	Clean Water Act
Savannah, GA	Lining landfills
St. Paul, MN	Clean Water Act - sewer separations
St. Petersburg, FL	Stormwater quality
St. Petersburg, FL	Clear Air/Asbestos Removal
St. Petersburg, FL	Toxic waste disposal
Topeka, KS	EPA regulation for Clean Water
York, PA	Resource Conservation and Recovery Act (RCRA)
York, PA	C.R.C.L.A. - superfund regulations
York, PA	Clean Water Act

LABOR ISSUES

Akron, OH	Medicare payments
Alexandria, VA	Section 504 of 1973 Rehabilitation Act (handicapped access)
Allentown, PA	Mandated social security tax
Boise, ID	Contracting requirements such as DBA
Charlotte, NC	FLSA
Charlotte, NC	Handicapped compliance

TABLE X (cont'd)

LABOR ISSUES

City	Issue
Decatur, IL	Wheelchair lifts on mass transit buses
Decatur, IL	DBA for prevailing wages
Detroit, MI	1990 Disability Act
Detroit, MI	Federal mandates covering all local employees under medicaid
Detroit, MI	FLSA requirements
Evanston, IL	Davis-Bacon Prevailing Wage Act
Glendale, AZ	Americans with Disabilities Act
Glendale, AZ	DBA requirements
Indianapolis, IN	Medicare coverage
Irvine, CA	Medicare requirements
Irvine, CA	Change in social security payments
Kansas City, MO	Low medicare/medicaid reimbursements
Los Angeles, CA	Medicare
Los Angeles, CA	FLSA
Louisville, KY	Mandated social security coverage
Madison, WI	FLSA
Madison, WI	Physical Accessibility - 504
Madison, WI	FLSA
Meridian, MS	FLSA
Mesa, AZ	Federal OSHA requirements
Mesa, AZ	FLSA
Mesa, AZ	OSHA requirements
Mesa, AZ	Handicap accessibility
Newark, CA	Regulations on Handicap Accessibility
Newark, CA	FLSA
Newark, CA	Medicare
Newark, CA	Social security
Oak Park, MI	Elimination of Federal Funds for on site job training (CETA)
Ogden, UT	Additional restrictions on federal funds
Pasadena, CA	Social Security
Pocatello, ID	Bid laws for public works projects DBA
Rochester, NY	Social security contributions requirements
Rochester, NY	Occupational safety regulations
Sarasota, FL	Medicare/aid for civil service employees
Sarasota, FL	FLSA
Sarasota, FL	Mandatory medicare insurance paperwork
Savannah, GA	FLSA
Savannah, GA	Social Security Act and amendments
St. Petersburg, FL	Handicapped Accessibility
St. Paul, MN	FICA/medicare changes
Topeka, KS	FLSA
Winston-Salem	JTPA
York, PA	Davis Bacon law

TABLE X (cont'd)

PUBLIC FINANCE

Akron, OH	Rebate of G.O. bond arbitrage
Decatur, IL	COBRA coverage for former employees and dependents
Evanston, IL	Arbitrage restrictions on municipal bonds
Houston, TX	Arbitrage rebate requirements
Jacksonville, FL	Arbitrage regulations
Jacksonville, FL	COBRA
Louisville, KY	Arbitrage rebate regulations
Ogden, UT	Arbitrage requirements
Pasadena, CA	Audits
Savannah, GA	COBRA
St. Paul, MN	Arbitrage regulations
York, PA	Single Audit Act

COMMUNITY DEVELOPMENT

Cheyenne, WY	General Revenue Sharing (GRS)
Cheyenne, WY	CDGB
Cranston, RI	Cut back in CDGB administrative cost
Jacksonville, FL	Loss of federal revenue sharing
Oak Park, MI	Cutback of monies for CDBG projects in areas designed to improve community standards
Oak Park,MI	Elimination of federal revenue sharing
Williamsport, PA	Elimination of GRS funds
Williamsport, PA	Reduction of CDGB entitlement funds
Winston-Salem, NC	GRS
Winston-Salem, NC	CDGB

OTHERS

Colorado Spgs. CO	Transit
Decatur, IL	Federal Hazard Communication Standards districts
Evanston, IL	Cost of the savings and loan industry bailout funds housing increases cost of debt service
Irvine, CA	Shift of financial burden to state
Madison, WI	MBE requirements
Oak Park, MI	Elimination of urban grants to business
Oak Park, MI	Cut back for monies for low and moderate income of capital equipment for mass transit

TABLE X (cont'd)

OTHERS

Ogden, UT	Federal defense budget restriction on federal
Ogden, UT	Federal redevelopment funding reductions private-activity bonds which substantially redevelopment of commercial and industrial
St.Paul, MN	Matching funds requirements - floodwalls
Topeka, KS	Revision of minimum wage laws
Williamsport, PA	Elimination of Urban Development Grant program
Williamsport, PA	Elimination of federal funds for acquisition of capital equipment for mass transit
Williamsport,PA	Restrictions imposed 1986 tax-reform Act on private activity bonds which substantially increases cost of debt service

CHAPTER VI

TOP CITY PRIORITIES IN 1990

When listing their top priorities, twenty-nine cities, or 58 percent of those responding, cited public safety issues, including drugs, police, and fire issues. Twenty-eight cities, or 56 percent said economic development was one of their top priorities. Twenty-six cities, or 52 percent, listed infrastructure in their list of top priorities. Twenty-four cities, or 48 percent, cited public finance issues in their list of top priorities. Twenty-one cities, or 42 percent of those responding, cited community/neighborhood development in their list of top priorities. Included in this category were responses citing quality of life issues.

Eighteen cities, or 36 percent said environmental issues were their top priority. This category included recycling responses.

Table XI shows the list of city priorities listed by cities for 1990.

Fifteen cities, or 30 percent cited social services in their list of top priorities. Nine cities, or 18 percent cited education issues, eight cities, or 16 percent responded that intergovernmental cooperation was their top priority. Thirteen cities, or 26 percent, have been placed in the others category which includes issues like youth programs and labor issues.

TABLE XI

Public Safety (Public Safety)

City	Issue
Akron, OH	Drug law enforcement
Albany, NY	Combatting drug abuse
Albany, NY	Public Safety
Alexandria, VA	Construction/full operating cost for homeless shelter/substance abuse center
Alexandria, VA	Continue efforts in coping with drug problems
Alexandria, VA	Anti-Drug enforcement efforts (public safety)
Allentown, PA	War on Drugs
Allentown, PA	Crime
Allentown, PA	Fire, emergency medical services and public
Baltimore, MD	Drug abuse, education, treatment and prevention
Baltimore, MD	Fire services
Baltimore, MD	Police protection
Binghamton, NY	Public safety-drug control
Boise, ID	Public Safety
Boston, MA	Public Safety/Anti-Drug Program
Charlotte, NC	Crime and drugs
Chicago, IL	Drug abuse education, prevention and treatment
Detroit, MI	"Boot" camp
Evanston, IL	Continued attention to public safety funding
Galveston, TX	Fire department
Galveston, TX	Police department
Glendale, AZ	Public safety (especially burglaries, drugs and gangs)
Houston, TX	Control of illegal drugs
Indianapolis, IN	Public Safety
Jackson, MS	Law enforcement
Jackson, MS	Police protection
Jackson, MS	Jail facilities
Los Angeles, CA	Improve paramedic/ambulance service
Los Angeles, CA	Increase police protection
N. Miami, FL	Continue police and community prevention
Newark, NJ	Continued of upgrading of police levels and
Oak Park, MI	Reduction of crime (especially in area of substance abuse)
Rochester, NY	Anti-drug programs
San Diego, CA	Meet public safety needs
Sarasota, FL	Public Safety
St. Petersburg, FL	Enhance public safety operations
St. Paul, MN	Management of drug related crimes
Topeka, KS	Crime
Williamsport, PA	Handle influx of people recovering from
Winston-Salem, NC	Public Safety

TABLE XI (cont'd)

Economic Development

Akron, OH	Economic development
Birmingham, AL	Open 7500 acre mixed use development
Boston, MA	Economic development
Charlotte, NC	Economic development
Colorado Spgs. CO	Economic development
Cranston, RI	Economic development
Detroit, MI	Enhanced Detroit-Canadian trade as result of U.S.- Canadian trade agreement
Evanston, IL	Economic development
Glendale, AZ	Economic development
Houston, TX	Economic development
Indianapolis, IN	Economic development
Jacksonville, FL	Economic development
Louisville, KY	Enterprise zone development
Meridian, MS	Downtown development
Mesa, AZ	Promote economic development
Oak Park, MI	Expansion of business and industrial facilities
Ogden, UT	Increased economic development
Phoenix, AZ	Economic viability
Pocatello, ID	Economic development/business expansion
Rochester, NY	Economic development
Sarasota, FL	Downtown redevelopment
Savannah, GA	Revitalization of downtown area
St. Paul, MN	Economic growth
St. Petersburg, FL	Strengthen economic vitality and redevelopment
Topeka, KS	Economic development
Williamsport, PA	Economic development to provide employment
Winston-Salem, NC	Economic development
York, PA	Complete City's Industrial Park

Community/Neighborhood Development

Albany, NY	Affordable housing
Allentown, PA	Quality of Life services
Baltimore, MD	Low and moderate income assisted housing (including homelessness)
Binghamton, NY	Housing
Birmingham, AL	Begin new residential programs for low and moderate income families
Boise, ID	Quality of life maintenance and improvements
Chicago, IL	Affordable housing funding
Decatur, IL	Establish neighborhood improvement strategy
Detroit, MI	Single family housing
Houston, TX	Quality of life
N.Miami, FL	Commence downtown art redevelopment program
Newark, NJ	Provision of low-income/affordable housing
Ogden, UT	Neighborhood rehabilitation

TABLE XI (cont'd)

Community/Neighborhood Development

Pasadena, CA	Address and maintain affordable housing
Pasadena, CA	Preserve and build elements that enhance the quality of life
Phoenix, AZ	Neighborhood/security
Phoenix, AZ	Community image and pride
San Diego, CA	Quality of life
Sarasota, FL	Community livability/quality of life
Savannah, GA	Homeless problem
Savannah, GA	Affordable housing
Savannah, GA	Livability and quality of neighborhoods
Savannah, GA	Removal of dilapidated buildings
St. Petersburg, FL	Maintain neighborhood identity and vitality
Williamsport, PA	Provide low and moderate income oriented assistance programs for housing and low-interest loans for housing rehabilitation
Williamsport, PA	Comprehensive code enforcement program
Winston-Salem, NC	Affordable housing

Infrastructure

Binghamton, NY	Street maintenance
Boise, ID	Repair and maintenance of infrastructure
Chicago, IL	New airport site in Chicago
Colorado Spgs. CO	Transportation and traffic improvements
Colorado Spgs. CO	Airport construction
Cranston, RI	Extension of sewers
Detroit, MI	Development of light rail system
Detroit, MI	Airport expansion
Evanston, IL	Construction of library
Evanston, IL	Improvements to sewer system
Galveston, TX	Street reconstruction
Glendale, AZ	Traffic (congestion and accidents)
Indianapolis, IN	Transportation
Irvine, CA	Resolution of transportation issues
Jackson, MS	Infrastructure
Kansas City, MO	Capital improvements
Los Angeles, CA	Reduce traffic congestion
Louisville, KY	Standiford Field airport expansion
Meridian, MS	Major capital improvement projects
Mesa, AZ	Work toward freeway and road improvements
Newark, CA	Establish capital improvement plan
Oak Park, MI	Completion of improvement of city-wide streets
Ogden, UT	Better freeway access to the city of Ogden
Pasadena, CA	Complete city's aggressive infrastructure programs
Pocatello, ID	Street repair and maintenance
Pocatello, ID	Downtown improvements: infrastructure, building repair and renovation

Infrastructure

Rochester, NY	Infrastructure maintenance
Sandy City, UT	Provide more funding for capital projects
St. Paul	Sewer separation/street reconstruction
Topeka, KS	Transportation system

Social Service

Akron, OH	Providing satisfactory public service without overtaxing citizens
Akron	Curbing spiraling health-care costs
Boise, ID	Meeting Boise's social service needs
Boston, MA	Maternal and child health
Indianapolis, IN	Social Programs
Kansas City, MO	Improving selected services
Madison, WI	Improve basic services
Madison, WI	Target special assistance to low-income families
Newark, CA	Maintain acceptable service levels
Newark, NJ	Expansion of health and counseling services for the AIDS crisis
Oak Park, MI	Maintaining high level of city services
Pasadena, CA	Develop human services strategy and the city's role in that strategy
Pocatello, ID	Maintain services at current levels
San Diego, CA	Maintain other essential city services
Sandy City, UT	Maintain service levels
St. Petersburg, FL	Provide essential public services
York, PA	Maintain services with little or no tax increase

Education

Alexandria, VA	Quality of public education
Baltimore, MD	Pre-K, elementary and secondary education
Charlotte, NC	Education
Cranston, RI	New schools
Cranston, RI	Education
Glendale, AZ	Education
N. Miami, FL	Enhance public school system and reduce overcrowding
Newark, CA	Implementation of policies and programs to improve education
Phoenix, AZ	Education

TABLE XI (cont'd)

Public Finance

City	Issue
Albany, NY	Resource management
Alexandria, VA	Residential real property tax relief base
Binghamton, NY	Balanced budget in light of diminished revenue
Birmingham, AL	Continue partnerships with other local governments in dealing with issues such as transportation and zoning
Boise, ID	Planning for future fiscal and community stability
Chicago, IL	Public/private partnerships to improve
Decatur, IL	Create housing and economic organization development efficiency and cost effectiveness
Evanston, IL	Identifying ongoing revenues and expenditure
Evanston, IL	Facing issue of higher expenditure growth than fee-based services governments in dealing with issues such as growth
Houston, TX	On-going management improvement incoming revenues
Irvine, CA	Shift of burden by feds and state to cities
Irvine, CA	Dealing with slowdown in economy and reduced
Jackson, MS	City reorganization
Jackson, MS	Fair taxation issues between city and county
Kansas City	Bond issues
Kansas City, MO	Increase in cash reserves
Kansas City, MO	Raising revenue
Madison, WI	Review alternative revenue sources
Madison, WI	Reduce amount of long-term debt
Madison, WI	Increase revenue sources from state
Meridian, MS	Local sales tax option
Meridian, MS	Consolidation of services
Mesa, AZ	Build foundation for long-term fiscal health
Newark, CA	Protect operating reserves
Newark, CA	More efficient use of resources (DS check if repeated this statement elsewhere)
Pasadena, CA	Ensure a sound financial base for the city
Rochester, NY	Budget/tax restraint
San Diego, CA	Achieve maximum cost recovery in provision of fee based service
St. Paul, MN	Cost containment
Topeka, KS	Broaden tax and revenue base
Topeka, KS	City-county cooperation
Williamsport, PA	Hold line on local taxes
Winston-Salem, NC	Budget and finance
York, PA	Develop strategic plan to address the 1990's
York, PA	Encourage state to legislate helpful tax reform measures

TABLE XI (cont'd)

City	Priority
Environment	
Akron, OH	Solid waste management
Albany, NY	Solid waste management
Binghamton, NY	Recycling
Colorado Spgs. CO	Park trails development
Cranston, RI	Open space
Decatur, IL	Continue work on recycling and solid waste
Decatur, IL	Complete water wellfield and begin lake dredging project
Glendale, AZ	Environment
Indianapolis, IN	Environment
Irvine, CA	Conservation of open space
Los Angeles, CA	Begin implementation of stormwater pollution control program
Los Angeles, CA	Begin implementation of recycling program
Louisville, KY	Downtown waterfront redevelopment
Louisville, KY	Phase-in curbside recycling program
Louisville, KY	Operation Brightside - citywide clean-up and beautification
Mesa, AZ	Develop solid waste management/recycling action
N. Miami, FL	Increase recycling efforts in community
N. Miami, FL	Resolution of munisport issue with Superfund requirements
Ogden, UT	Improve park facilities
Phoenix, AZ	Environment
Sarasota, FL	Waterfront protection and improvement
Sarasota, FL	Environment protection and enhancement
St. Petersburg, FL	Protect and enhance waterfront and open spaces
Winston-Salem, NC	Environment protection including waste removal
Others	
Charlotte, NC	Public resources
Chicago, IL	Zebra mussels
Decatur, IL	Begin GIS application,development and programming
Houston, TX	Employee compensation and improved productivity
Newark, NJ	Creation of additional recreational opportunities for youth
Ogden, UT	Better programs for our youth
Pocatello, ID	To fund new salary/benefit program
York, PA	Determine extent of 1990 census error and refute if warranted

TABLE XII

CITIES AND POPULATIONS RESPONDING TO SURVEY

Of the 50 cities responding to the survey, seven cities had populations between 30,000 and 50,000. Ten cities represented populations of between 100,000 and 200,000. Thirteen cities had populations of between 200,000 and 500,000 and ten cities had populations of 500,000 and above. Half of those cities responding with populations above 500,000 represented cities with populations above 1 million.

CITY	POPULATION	CITY	POPULATION
Akron, OH	222,060	Los Angeles, CA	3,310,057
Albany, NY	97,020	Louisville, KY	286,470
Alexandria, VA	107,800	Madison, WI	175,830
Allentown, PA	104,360	Meridian, MS	42,970
Baltimore, MD	752,800	Mesa, AZ	300,317
Binghamton, NY	52,910	Newark, CA	37,420
Birmingham, AL	277,510	Newark, NJ	316,240
Boise, ID	108,390	North Miami, FL	42,650
Boston, MA	573,600	Oak Park, MI	31,120
Charlotte, NC	352,070	Ogden, UT	67,490
Cheyenne, WY	53,960	Pasadena, CA	129,900
Chicago, IL	3,021,912	Phoenix, AZ	981,846
Colorado Spgs. CO	272,660	Pocatello, ID	44,420
Cranston, RI	73,760	Portland, OR	432,175
Decatur, IL	90,360	Rochester, NY	235,970
Detroit, MI	1,200,000	San Diego, CA	1,086,592
Evanston, IL	71,570	Sandy City, UT	67,430
Galveston, TX	60,210	Sarasota, FL	51,500
Glendale, AZ	125,820	Savannah, GA	146,800
Houston, TX	1,729,720	St. Paul, MN	263,680
Indianapolis, IN	719,820	St. Petersburg, FL	239,410
Irvine, CA	104,781	Topeka, KS	118,580
Jackson, MS	208,420	Williamsport, PA	31,710
Jacksonville, FL	658,437	Winston-Salem, NC	148,080
Kansas City, MO	441,170	York, PA	44,430

CITY FISCAL DISTRESS:

STRUCTURAL, DEMOGRAPHIC AND INSTITUTIONAL CAUSES

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CITY FISCAL DISTRESS

INTRODUCTION

The roots of local fiscal stress and crisis can be found in converging patterns of economic, social, and intergovernmental change. It is these deeper patterns, rather than short-term political or management behavior that dominates headlines, that require the attention of policy-makers at all levels.

1. The United States is undergoing a major industrial restructuring. All cities and metropolitan areas are affected by this process of economic change. For many, particularly the nation's central cities, the consequence of this process of economic change is steady erosion of their tax bases concurrent with increasing joblessness.

   - Per capita income in the largest central cities is approximately 58.5 percent of that of their suburbs on average. The range of these income disparities between cities and suburbs around this average, however, is great. The magnitude of these income disparities is a clear indicator of the disparities in their tax bases.

   - The evidence suggests that disparities in per capita income between cities and suburbs may have increased dramatically in the 1980s. Confirmation of this trend must await availability of data from the 1990 Census.

   - There are also significant differences in rates of unemployment between almost all cities and their suburbs. In a few, such as Detroit, Baltimore and St. Louis, central city unemployment rates are almost double those experienced in their suburbs.

2. *Major demographic shifts* have combined with structural economic change to erode the tax bases of central cities. More than 5.5 million more people lived in poverty at the end of the decade of the 1980s than ten years previously. Over this period, poverty became increasingly concentrated in the nation's central cities. These trends result in systematic differentials among localities in income, wealth, and poverty. These differences create fiscal stresses in many central cities.

3. *Changes in the intergovernmental system* are increasing the fiscal squeeze on cities and towns throughout the United States.

   - Federal cutbacks and fiscal retrenchment in many states have significantly reduced the share of local revenues provided by the federal government and states.

   - The escalating costs of federal and stated mandated programs are placing growing fiscal burdens on cities.

   - Some states impoverish their cities by tightly regulating types of taxes cities can use and by exercising detailed controls over tax rates and assessment practices.

The current economic recession compounds the problems of cities already attempting to cope with difficult fiscal circumstances. Even without a recession and with the best practices of fiscal management, many cities and towns will face severe fiscal difficulties in the 1990s as a result of the differential effects of these trends.

I. ECONOMIC RESTRUCTURING AND FISCAL DISPARITIES

Even as all levels of government--federal, state, and local--attempt to deal with the fiscal pressures created by the recession, their economies are undergoing a process of industrial restructuring. This process is driven by new technologies, changing tastes and values of consumers, and changing patterns of regional and international competition.

No region, city or town will be immune to these forces of economic change. A 1988 study of the future of the U.S. economy concluded:[1]

> *During the next two decades, new technologies, rapid increases in foreign trade, and the tastes and values of a new generation of Americans are likely to reshape virtually every product, every service, and every job in the United States. These forces will shake the foundations of the most secure American businesses. Few features of the change seem inevitable.*

This process of industrial transformation is essential to the long-term competitiveness of the nation in the global economy and to that of U.S. regions. The strength of cities and their regional economies is directly related to their capacity to facilitate the transition to new economic functions in response to the changing requirements of the national and global economies.

But these patterns of economic change differ across regions, states, and localities. As a consequence, different cities and towns attempt to meet the needs of their residents and to balance their budgets with very different resource bases from which to derive revenues. Many jurisdictions in the United States have been adversely affected by the ongoing restructuring of their economies.

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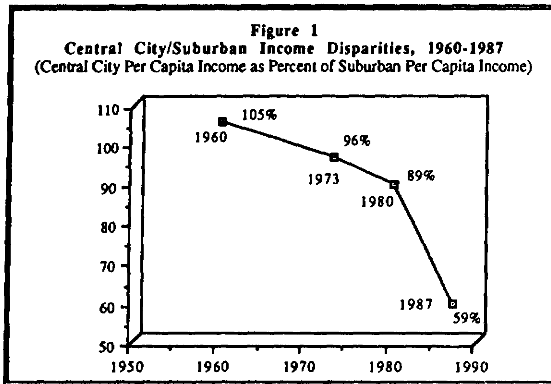
[1]U.S. Congress, Office of Technology Assessment, *Technology and the American Economic Transition: Choices for the Future* OTA-TET-283, (Washington, D.C.: U.S. Government Printing Office, May 1988), p.3.

Per capita income is a measure of the economic health of places, a reflection of the potential tax base, and an indicator of the economic welfare of a city's residents. The magnitude of disparities between per capita income of cities and their suburbs are a mirror of differences in their tax bases. For some, these disparities are sharp and distinct.

A substantial decline in the economic welfare of cities relative to their suburbs has been occurring since at least 1960, and a precipitous drop appears to have occurred in the 1980s (Figure 1). In 1960, per capita income was five percent greater in cities in metropolitan areas than in their suburbs.[2] By 1973, per capita income in cities had fallen to 96 percent of their suburbs.[3] Seven years later, in 1980, this ratio had fallen to 89 percent.[4] This decline in the economic welfare of cities relative to suburbs appears to have accelerated sharply in the 1980s. By 1987, per capita income in central cities was only 59 percent of that of their suburbs.[5]

Figure 1
Central City/Suburban Income Disparities, 1960-1987
(Central City Per Capita Income as Percent of Suburban Per Capita Income)



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[2]Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, D.C.: ACIR, February 1977), p. 40.
[3]Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, D.C.: ACIR, February 1977), p. 40.
[4]This figure is based on a sample of the 85 largest cities in 1980. See Advisory Commission on Intergovernmental Relations, *Fiscal Disparities: Central Cities and Suburbs, 1981* (Washington, D.C.: U.S. Government Printing Office, 1984)
[5]This is the average ratio for the sample of 62 cities and their suburbs presented in the Appendix. This sample is a majority of of large cities for which 1990 Census data initially became available.

These comparisons between 1980 and 1987 must be viewed with caution.[6] Nonetheless, the orders of magnitude are striking. A great deal of attention has focused on the polarization of incomes in the United States in the last decade. These data provide a geographical dimension to this issue. Quality of life is directly related to geographical places and the economic vitality of these places. If, indeed, we are witnessing increasing disparities between per capita incomes in cities and their suburbs, the issue of the fiscal limitations of cities must be addressed anew. Final documentation of this trend toward increasing city-suburb income disparities must await the availability of data from the 1990 Census.

Figure 2 identifies 20 larger cities with very large city/suburban differences in per capita income in 1987. The range of variation in the ratio of city and suburban per capita income is large. Within this set of 20, the city with the highest per capita income, San Francisco, also has the highest suburban per capita income.

Figure 2
CITY/SUBURBAN INCOME DISPARITIES
PER CAPITA INCOME, 1987

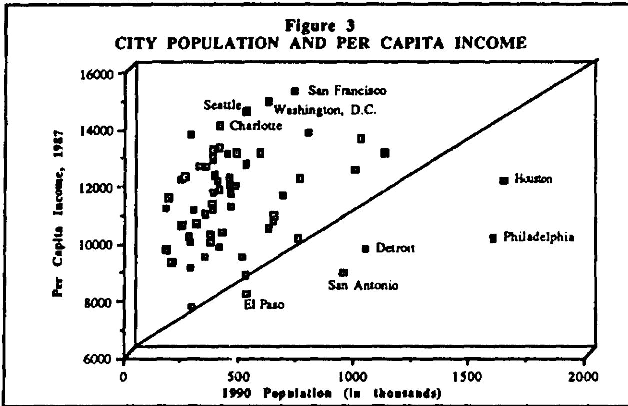
Per Capita Income
40000
30000
20000
10000
0

City
Suburb

[6]Caution is required both because of the computational steps necessary to estimate 1987 per capita income for suburbs and the slightly different samples of cities used to generate the average figures for the two years.

There does not appear to be any consistent relationship between population size of cities and economic health, as measured by per capita income. As illustrated in Figure 3, the range of variation is great. Per capita income among these cities in 1987 ranged from over $15,000 in San Francisco to less than $8,000 in Louisville.[7] Some cities, such as San Francisco, Washington D.C., Seattle, and Charlotte are doing well by this measure of economic health. Other large cities like Philadelphia, Detroit, San Antonio and Philadelphia have relatively low per capita incomes. Even within the set of cities with populations between 100,000 and a half million, the variation in per capita income is extremely wide.

Figure 3
CITY POPULATION AND PER CAPITA INCOME



[7]Clearly, the cost of living differs significantly among the cities in Figure 3. The differences in real or cost of living adjusted per capita income would be less.

Unemployment is another measure of both the economic vitality of a city and the potential service demands of an affected population. Although data are limited, the evidence is strong that central city unemployment rates greatly exceed those of many metropolitan areas. Figure 4 examines the differentials of 15 metropolitan areas for which data are available. With the single exception of San Diego, the central cities of these areas are more sharply impacted by joblessness.

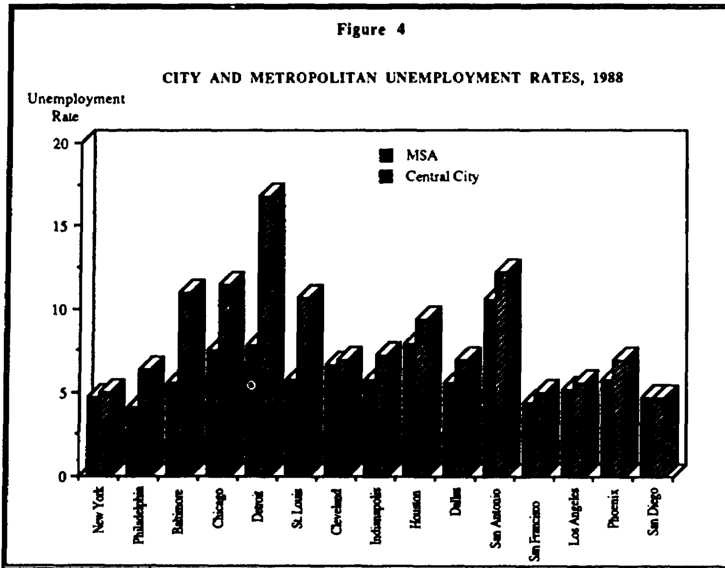


Figure 4

CITY AND METROPOLITAN UNEMPLOYMENT RATES, 1988

Demographic trends also provide a mirror of the changing economic fortunes of cities and their suburbs. Between 1980 and 1990, 19 major cities lost population (Figure 5). Of these only five were in metropolitan areas that lost population. The rest were in growing metropolitan areas, some of which were growing rapidly even as their central cities declined in size.

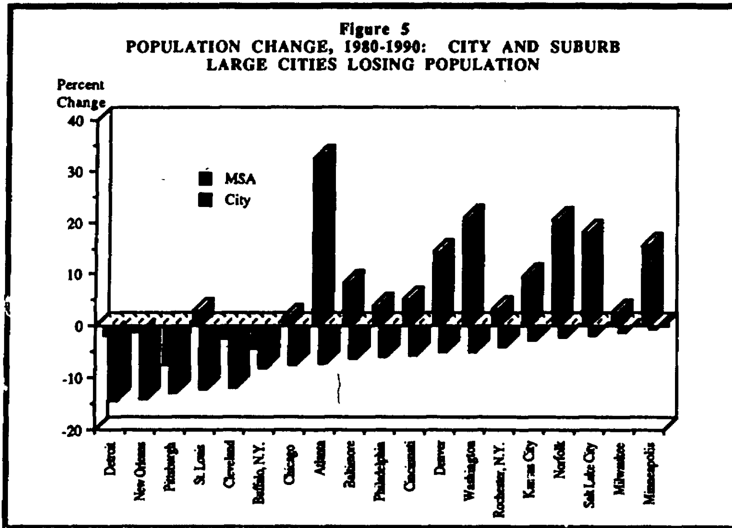


Figure 5
POPULATION CHANGE, 1980-1990: CITY AND SUBURB
LARGE CITIES LOSING POPULATION

II. THE BURDEN OF POVERTY

Demographic change has combined with the dramatic structural changes in the economies of central cities to erode the tax bases of many of these jurisdictions. Most important of these are the movement of higher income households from cities to suburbs and the increasing concentration of poverty in central cities and cities and towns in nonmetropolitan areas.

In 1987, NLC pointed to the linkage between the performance of the national economy and poverty (*Poverty in America: New Data, New Perspectives).*

> *The direction of this causation, however, is not only from the national economy to poverty. Poverty has a breaking influence on the vitality of the economy. Responding to the critical needs of those in poverty directs scarce national resources from other uses which might spur economic growth. Further, the segment of the poverty population which might be added to the workforce should be viewed as a national resource whose potential can promote economic growth.*

This 1987 research report documented the increasing urbanization of poverty in the United States between 1979 and 1985, a year when the rate of poverty stood at a twenty-year high (1970-1989).

A decade of structural economic change and recessions in the 1980s and early 1990s have increased poverty in the United States.

> *More than 5.5 million more people were living in poverty in 1989 than ten years previously.*

The rate at which poverty afflicted Americans increased by one percent over the decade 1979-1989 (Figure 6). This increased poverty rate accounted for fully one-half of the increase in poverty between the beginning and end of the decade. The other half occurred because of overall population growth. Recession in the early 1980s sharply increased poverty. Relative prosperity in the last five years of the decade brought this rate back to levels similar to those at the beginning of the decade.

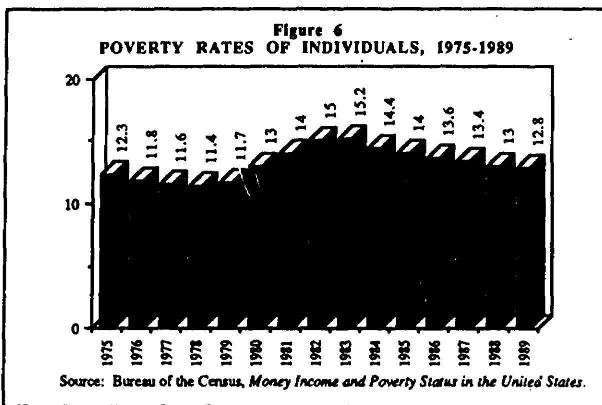


Figure 6
POVERTY RATES OF INDIVIDUALS, 1975-1989

Source: Bureau of the Census, *Money Income and Poverty Status in the United States.*

Central cities experienced the highest rates of poverty again in 1989, as they did in 1985 and in 1979 (Figure 7). By 1989, there were approximately 4.4 million more persons in poverty in central cities than in 1979. Nonmetropolitan areas continued to experience high rates of poverty. The incidence of poverty increased by two percentage points over the decade, although the number of those in poverty in nonmetropolitan areas decreased by slightly more than one million over this ten-year period.

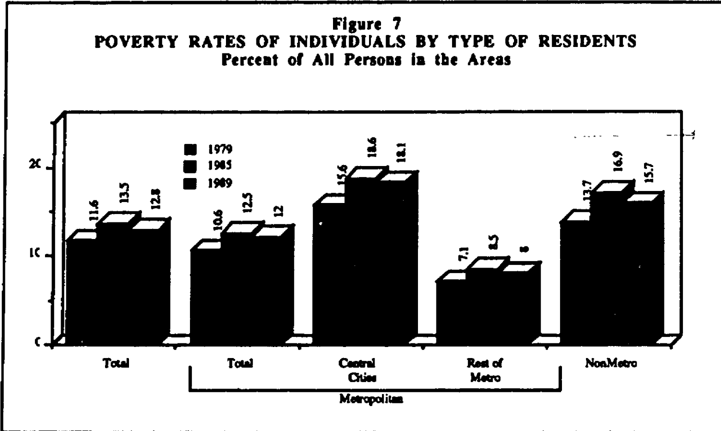
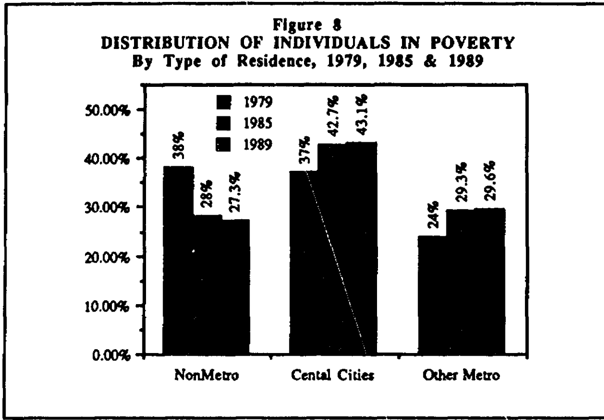


Figure 7
POVERTY RATES OF INDIVIDUALS BY TYPE OF RESIDENTS
Percent of All Persons in the Areas

The relative prosperity of the last five years of the decade did not, by this measure, favor the suburbs. Although suburbs had the lowest rates of poverty in each of the three years examined, the incidence of poverty in the suburbs of metropolitan areas decreased by only one-half of one percentage point between 1985 and 1989, the same as in the metropolitan area as a whole and in their central cities.

Slightly more than 60 percent of all those afflicted by poverty lived in metropolitan areas in 1979. The remainder lived in nonmetropolitan areas. The data do not identify how many of these were in nonmetropolitan cities and towns. The urban share of those in poverty, however, is clearly greater than simply that of central cities and their suburbs (Figure 8).

Figure 8
DISTRIBUTION OF INDIVIDUALS IN POVERTY
By Type of Residence, 1979, 1985 & 1989



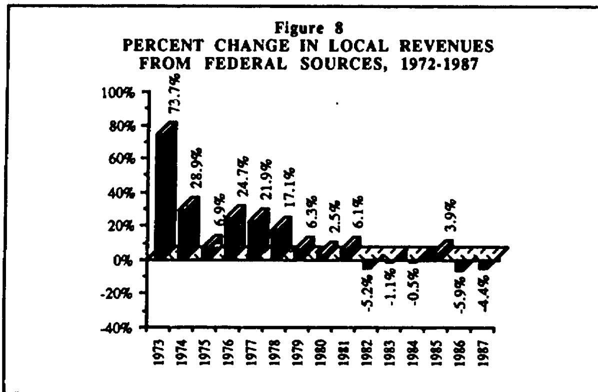
Ten years later, by 1989, 72.7 percent of those in poverty were in metropolitan areas. This represents an increase of over 10 percentage points in the metropolitan share of poverty.

Poverty is increasingly concentrated in central cities in the United States. Over the decade, the central city's share of the nation's poor increased from 37 to 43 percent or by six percentage points. The economic recovery of the 1980s had little effect on the incidence of poverty in central cities, and their share of the nation's poor increased as the national economy grew. Although the proportion of those in poverty in suburban rings increased by over this period, sharp disparities between central cities and suburbs in both rates and shares of poverty remained at the end of the decade.

III. CHANGES WITHIN FEDERAL SYSTEM

Critics of urban fiscal management often fail to recognize how these changes within the intergovernmental systems, as well as the control states exercise over taxing sources available to cities, affect the fiscal conditions. Federal cutbacks, current budget shortfalls in many states, and escalating mandated costs are increasing the fiscal burdens of cities and towns, even as many attempt to cope with the costs of economic and demographic change.

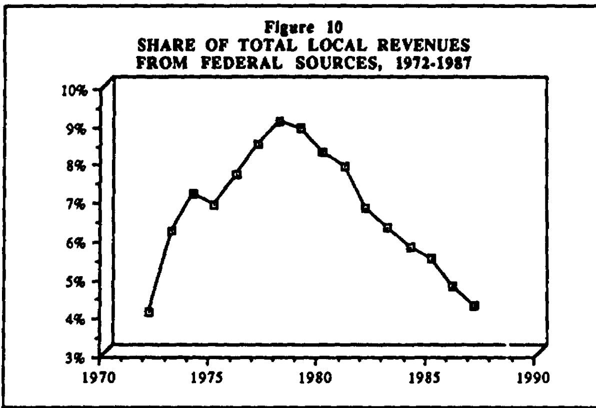
The federal government has retreated from its commitment to the welfare of cities made in the late 1960s. Since roughly 1986, federal assistance to local governments has been declining (Figure 9).[8] Adjustment of federal assistance to local governments for inflation would further accentuate the precipitousness of the federal retreat in its commitment to local governments.



[8]Data for Figures 9-13 are from Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, (Washington, D.C.: January 1989).

The share of total local government revenues provided by the federal government, after increasing throughout the 1970s, began to decline precipitously in 1980 (Figure 10). In 1978 intergovernmental transfers from the federal government constituted 9 percent of local government revenues. By 1987, this figure had decreased to 4.2 percent. In 1986, as part of the New Federalism, general revenue sharing, a major source of unrestricted funding for cities, was eliminated. Other programs providing assistance to cities have been systematically pared or eliminated.

Figure 10
SHARE OF TOTAL LOCAL REVENUES FROM FEDERAL SOURCES, 1972-1987



Prospects for increased federal funding to meet domestic priorities and address the problems of the nation's cities are extremely limited. Continuing federal deficits, the growing federal debt, political opposition to new taxes, and lack of political consensus on national goals effectively preclude any federal response to the needs of cities.

Even as federal assistance to cities has declined, the cost of federal mandates to cities has soared. In particular, environmental and medical care mandates, unaccompanied by federal funds for implementation, now pose major challenges to city fiscal capacities. In addition, new controls on the ability of local governments to issue bonds legislated in the 1986 Tax Act further handicap cities as they attempt to address their fiscal needs.

The ability of states to assist cities has been constrained by their own expanded responsibilities under the New Federalism and by their own budgetary problems. Between 1980 and 1985, the state share of total local revenues declined (Figure 11). Since 1985, this contribution appears to have stabilized. In 1975, the state share of total local revenues was 32 percent. By 1987, this share was 29 percent.

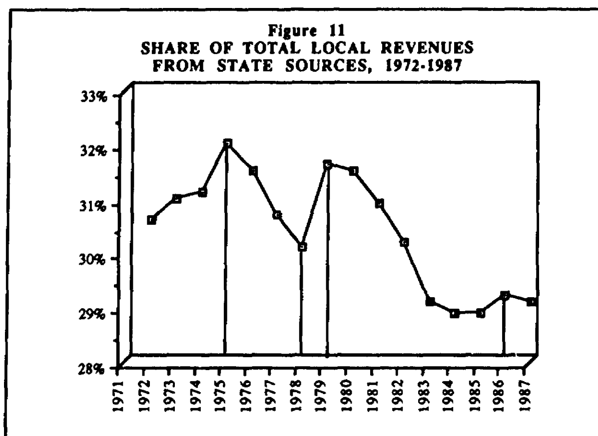


Figure 11
SHARE OF TOTAL LOCAL REVENUES FROM STATE SOURCES, 1972-1987

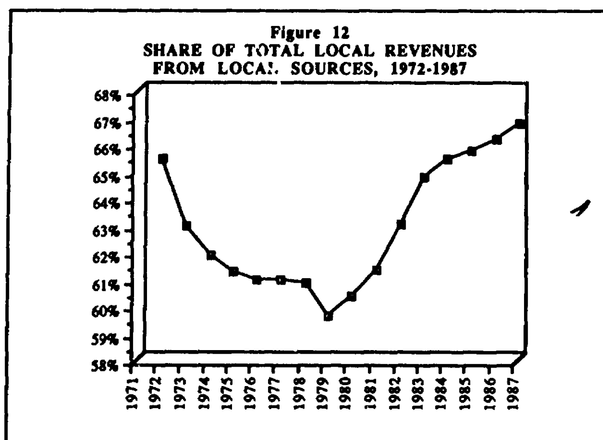
In the current recession, however, 28 states confront serious deficits that will require cutbacks in programs, including those benefiting cities, and, in some cases, tax increases. This will hamper the ability of many states to respond to fiscal stress of cities through increased assistance.

States have also increased fiscal pressures on cities through mandates. In many cases, cities are mandated by states to provide services without any state provision for funding. Some states have attempted to address this problem. California and Florida, for example, have passed reimbursement acts that require mandates to be accompanied by funding. Florida legislation permits any mandates for which funding is not provided to be ignored by local governments. Other states require fiscal notes which are financial impact

statements of the costs to local governments of pending mandate legislation. Fiscal notes, by specifying the costs of pending mandates, are intended to force consideration of costs in the legislative process.

States can impoverish their cities through state policies regulating the type of taxes local governments can use. In some states, cities may use any taxes not prohibited by state legislation. In others, cities must be authorized to used particular taxes by state legislation. In addition, some states exercise fairly detailed controls over local tax rates and assessment practices.

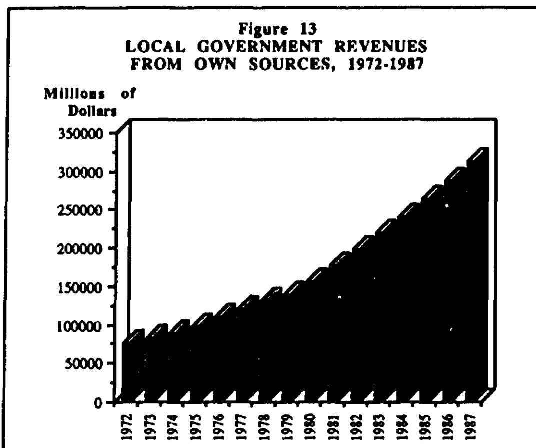
Local governments have not been passive over this period. The share of local revenues that had to be derived from local sources has increased sharply since 1980, after falling consistently throughout the 1970s (Figure 12). In 1979, local governments derived slightly less than 60 percent of their revenues from local sources. By 1987, this figure was almost 67 percent.



This increased local share is not an artifact of federal cutbacks. During this period local governments were significantly increasing the revenues they derived from their own sources (Figure 13). Between 1979 and 1987, locally generated revenues increased by 84.4 percent.

Despite this increased level of local revenue effort, some cities and towns are experiencing fiscal distress because of economic and demographic change, and changes and restrictions within the intergovernmental system. Fiscal crises resulting from these structural and institutional problems cannot be addressed by cities acting alone, particularly where local revenue efforts are already high.

Figure 13
LOCAL GOVERNMENT REVENUES FROM OWN SOURCES, 1972-1987



Answers must be found within the intergovernmental system, in metropolitan regionalism, and by addressing the negative tax climate that pervades cities and states. Among these are:

- The federal and state governments must recognize that cities, acting alone, cannot effectively address structural and institutionally induced fiscal distress. Both of these levels of government should consider programs to assist cities confronting budgetary problems due to these sources.

- In addition, both the federal government and states must recognize the increasing costs of mandates on cities and towns. New mandates should be accompanied by revenues for implementation, especially for local governments already confronting fiscal problems.

- The federal and local governments should recognize the burden on city fiscal systems created by the increasing concentration of the nation's poor in central cities. Poverty is not simply the responsibility of cities. Federal and state programs should assist central cities, as well as distressed jurisdictions in suburbs and nonmetropolitan areas, in responding to the needs of those in poverty.

- States should address the issue of the effects of restrictive state tax policies on the ability of local governments to respond to their fiscal problems.

- In an era of federal and state deficits, part of the answer must be found within metropolitan areas. Metropolitan areas are a single regional economy. The economic health of any jurisdiction within the region affects the health and potential of the whole. The decade of the 1990s must be a period of coalition building and tax base sharing among jurisdictions within metropolitan areas.

- An unfortunate legacy of the 1980s is the prevailing pejorative attitudes toward any new taxes, even when the need is great and the justification strong. This must change. In particular, cities cannot respond to their own fiscal needs if their ability to derive new revenues is restricted by voter unwillingness to approve new taxes or tax rates.

APPENDIX

CENTRAL CITY/SUBURBAN DISPARITIES IN INCOME

CENTRAL CITY/SUBURBAN DISPARITIES IN PER CAPITA INCOME

RANK	CITY	PER CAPITA INCOME		
		CITY 1987 ($)	SUBURBAN ($)	CITY AS PERCENT OF SUBURBAN
1	Newark	7,622	23,747	32.1%
2	El Paso	8,027	19,049	42.1%
3	Cleveland	8,690	20,305	42.8%
4	Boston	12,984	30,158	43.1%
5	Chicago	10,806	24,005	45.0%
6	San Jose	13,711	29,468	46.5%
7	San Francisco	15,137	32,315	46.8%
8	Memphis	10,347	21,919	47.2%
9	Baltimore	9,989	21,054	47.4%
10	Philadelphia	10,002	20,692	48.3%
11	Detroit	9,662	19,755	48.9%
12	Milwaukee	10,593	21,104	50.2%
13	Buffalo	9,354	18,072	51.8%
14	Toledo	10,872	20,344	53.4%
15	St. Louis, MO	9,718	18,074	53.8%
16	Tucson	10,204	18,837	54.2%
17	Jacksonville	11,514	21,136	54.5%
18	Albuquerque	11,988	21,515	55.7%
19	Rochester, NY	10,456	18,758	55.7%
20	Dayton	9,135	16,255	56.2%
21	Birmingham, AL	8,954	15,892	56.3%
22	Fresno	10,151	17,759	57.2%
23	Indianapolis	12,111	21,057	57.5%
24	Miami	9,830	16,941	58.0%
25	New Orleans	9,340	16,083	58.1%
26	Oakland	12,215	20,909	58.4%
27	Columbus	10,811	18,248	59.2%
28	Louisville	9,852	16,574	59.4%
29	Wichita	12,48[illegible]	20,521	60.8%
30	Fort Worth	11,082	17,938	61.8%
31	Austin	11,860	19,103	62.1%
32	Houston	12,007	18,457	65.1%
33	Atlanta	11,689	17,892	65.3%
34	Dallas	13,489	20,415	66.1%
35	Wash. D.C.	14,778	22,310	66.2%
36	Norfolk, VA	10,070	15,165	66.4%
37	Cincinnati	11,223	16,892	66.4%
38	San Bernardino	9,623	14,471	66.5%
39	Pittsburgh	10,988	16,397	67.0%
40	Phoenix	12,375	18,353	67.4%
41	Denver	12,980	19,174	67.7%
42	Los Angeles	13,592	20,070	67.7%
43	Sacramento	11,580	17,057	67.9%
44	Portland, OR	11,830	17,293	68.4%
45	Kansas City, MO	12,077	17,552	68.8%

CENTRAL CITY/SUBURBAN DISPARITIES IN PER CAPITA INCOME

46	Omaha	12,480	18,112	68.9%
47	Tampa	11,004	15,783	69.7%
48	San Diego	12,978	18,602	69.8%
49	Minneapolis	13,092	18,675	70.1%
50	Nashville-Dvsn.	12,583	17,669	71.2%
51	Long Beach, CA	12,947	17,774	72.8%
52	Oklahoma City	11,547	15,818	73.0%
53	Seattle	14,438	19,369	74.5%
54	St. Petersburg	12,170	15,501	78.5%
55	Newport News, VA	11,396	14,463	78.8%
56	Tulsa	12,829	15,785	81.3%
57	Honolulu	14,483	17,448	83.0%
58	Riverside, CA	12,034	14,371	83.7%
59	Salt Lake City	11,064	12,590	87.9%
60	Charlotte	13,970	15,519	90.0%
61	Virginia Beach	13,141	14,455	90.9%
62	San Antonio	12,592	12,893	97.7%
	Average	10,796	18,469	58.5%

Fiscal Survey of the States

April 1991

by

Marcia A. Howard

National Governors' Association
National Association of State Budget Officers

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Preface

The *Fiscal Survey of the States* is published twice annually by the National Association of State Budget Officers (NASBO) and the National Governors' Association (NGA). The series was started in 1977. The survey presents aggregate and individual data on the states' general fund receipts, expenditures, and balances. While not the totality of state spending, these funds are used to finance most broad-based state services and are the most important elements in determining the fiscal health of the states. A separate survey that includes total state spending also is conducted annually.

The field survey on which this report is based was conducted by the National Association of State Budget Officers in January, February, and March 1991. The surveys were completed by Governors' state budget officers in the fifty states. Due to gubernatorial elections, Alabama and Rhode Island have not yet submitted 1992 budget proposals.

Fiscal 1990 data represent actual figures, fiscal 1991 figures are estimates, and fiscal 1992 data are figures contained in proposed 1992 budgets. In forty-six states, fiscal 1991 will close on June 30, 1991. New York's fiscal year ended March 31, 1991. Texas' fiscal year will end on August 31, 1991, and Alabama and Michigan will close their fiscal years on September 30, 1991.

The *Fiscal Survey of the States* is a cooperative effort of the National Association of State Budget Officers and the National Governors' Association. Marcia Howard of the National Association of State Budget Officers compiled data for the report and prepared the text. Laura Shaw produced the report.

Executive Summary

In September 1990 the *Fiscal Survey of the States* warned that "state fiscal conditions for 1991 are based on budgets that assume slow, but positive, growth. They do not anticipate a recession. If a recession were to occur, states would be in substantially worse condition than the data in this report indicate."

A recession did occur and, consequently, state fiscal conditions in 1991 are the worst in nearly a decade. The most important single indicator of state fiscal health--total balances--has fallen to a level of $5.9 billion, or just 2.0 percent of expenditures. Excluding a large surplus in Alaska, balances are estimated at just 1.5 percent of expenditures. The last time balances were this low was in 1983 when they also dropped to 1.5 percent of expenditures.

States entered this recession in a much weaker position than they entered the recession of the early 1980s. While the underlying economy was worse in the earlier recession, state budgets are faring worse now. As a result, a prolonged recession could batter state budgets very badly. Based on state estimates, ending balances contained in Governors' proposed 1992 budgets will total $6.1 billion. If the recession persists, even this modest improvement will be almost impossible to achieve.

The recession has blurred, but not eliminated, strong regional differences in state fiscal health. The eastern United States is in worse condition than the western United States and northeastern states continue to face the most severe budget crises. While almost every state in the Northeast has faced large budget shortfalls this year, few states west of the Mississippi River have reported significant budget problems.

Even without a recession state fiscal conditions would be weak. Some argue that state tax systems cannot generate sufficient revenues to support current programs. Medicaid, which grew by more than 18 percent in fiscal 1990, is consuming more resources than current state tax levels can provide. This causes one of two things to happen: other programs must be scaled back to pay for increased Medicaid spending or taxes must be increased. In many states both options are being pursued.

Thirty-seven states will spend more on Medicaid than they originally budgeted for fiscal 1991. Until this program is brought under control, state budgets are likely to remain in severe distress and Governors will be forced to scale back or abandon other program initiatives.

Other major findings of this survey include:

- Reflecting the extreme difficulties states face, twenty-nine states have reduced fiscal 1991 budgets by $8 billion.

- Proposed state revenue increases for fiscal 1992 total $6.6 billion. If the recession persists, this amount is likely to grow as states exhaust other balancing options.

- Governors' fiscal 1992 budgets contain growth of just 4.8 percent. This is the lowest rate of growth since 1983 and represents a reduction of services in many states.

- Federal increases in cigarette, alcohol, and gasoline taxes have reduced state tax activity in these areas. The number of states proposing increases in these taxes has declined dramatically since the federal increases were enacted.

I. State Expenditure Developments

Overview

State budgets were projected to grow by 6.5 percent in fiscal 1991. As the year progressed and the nation experienced a recession, state fiscal conditions deteriorated even further and spending was scaled back to avoid deficits. As a result, state spending for fiscal 1991 in now estimated at 5.2 percent, the lowest rate of growth since 1983. Summaries of state spending for fiscal 1990, 1991, and 1992 are contained in Appendix Tables A-1, A-2, and A-3.

Table 1 shows the volatility of state spending over the last fourteen years. The growth in fiscal 1992 budgets—estimated at just 4.8 percent—represents the second lowest level of growth since these data have been collected. The only year with lower growth was 1983, when a severe and prolonged recession drained state resources and spending was actually reduced from the prior year's level. While the current recession has been less severe, state budgets have been hit harder and spending growth has been reduced only months into the downturn.

Table 1
STATE NOMINAL AND REAL ANNUAL BUDGET INCREASES, FISCAL 1979 TO FISCAL 1992

	State General Fund	
Fiscal Year	*Nominal Increase*	*Real Increase*
1992	4.8% (est.)	0.3% (est.)
1991	5.2 (est.)	0.3 (est.)
1990	6.4	1.7
1989	8.7	3.5
1988	7.0	2.9
1987	6.3	2.6
1986	8.9	3.7
1985	10.2	4.6
1984	8.0	3.3
1983	-0.7	-6.3
1982	6.4	-1.1
1981	16.3	6.1
1980	10.0	-0.6
1979	10.1	1.5
1979-92 average	7.7%	1.6%

NOTE: The state and local government implicit price deflator was used for state expenditures in determining real changes.

SOURCE: National Association of State Budget Officers

While no states enacted budgets in 1989 that were lower than the previous year, three did so in 1990, seven did so in 1991, and eight are expected to do so in 1992. This reflects the general weakening in state fiscal conditions over the last two years and the pessimistic outlook for fiscal 1992. Whereas sixteen states had more than 10 percent budget growth in fiscal 1990, Table 2 shows that eleven exceeded 10 percent growth in fiscal 1991 and only seven are expected to exceed in it fiscal 1992.

Table 2
ANNUAL STATE GENERAL FUND EXPENDITURE INCREASES,
FISCAL 1991 AND FISCAL 1992

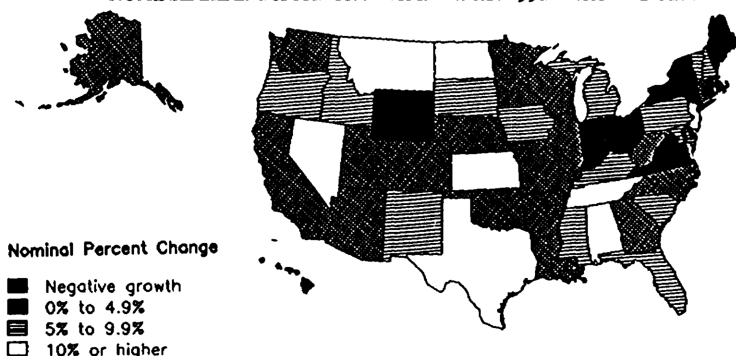
Spending Growth (percentage)	*Number of States* Fiscal 1991 (Estimated)	Fiscal 1992 (Proposed)*
Negative Growth	7	8
0.0% to 4.9%	15	19
5.0% to 9.9%	17	14
10% or Higher	11	7
Average Growth Rate	5.2%	4.8%

NOTE: Data for Alabama and Rhode Island are not available.

SOURCE: National Association of State Budget Officers

Regional variations in spending growth are beginning to blur, as more states are affected by the slow national economy. Figure 1 shows that no region exhibits remarkably strong growth or steep declines. The majority of states fall into the mid-range of budget growth, with increases near the national average of 4.8 percent.

Figure 1
NOMINAL EXPENDITURE GROWTH IN FISCAL 1992 STATE BUDGETS*



*Data for Alabama and Rhode Island are not available.

SOURCE: National Association of State Budget Officers

Budget Management

States generally strive for balanced budgets and, for the most part, achieve them through spending cuts or revenue increases when those become necessary. In fiscal 1991, states have had to take dramatic action to balance their budgets in order to avoid ending the year with a deficit.

Table 3 lists the states that have reduced their fiscal 1991 budgets and the size of these reductions. In total, budget cuts that have been proposed or enacted amount to more than $8 billion. This amount is alarming because it exceeds the amount of tax and revenue increases proposed in Governors' 1992 budgets, confirming that budget cutting is playing a very important part in balancing state budgets.

Frequently, certain programs will be exempted from cuts. Table 3 also identifies programs that have been exempted this year. These exemptions reflect both legal considerations and Governors' priorities. For example, debt service on bonds is exempted in some states because repayment represents a contractual arrangement. Medicaid is often exempted because it is an entitlement

Table 3
BUDGET CUTS MADE AFTER THE FISCAL 1991 BUDGET PASSED*

State	*Size of Cut (millions)*	*Programs or Expenditures Exempted from Cuts*
Alabama	$90.7	Debt service
Arizona	108.0	K-12 education
California	500.0	Debt services, Proposition 98 (K-14 education), constitutional expenditures
Colorado	43.0	K-12 education (partial and if revenues improve)
Connecticut	56.0	Direct care programs
Delaware	43.9	Federal and state mandated programs
Florida	749.9	Cuts are targeted to less sensitive areas
Georgia	359.0	Law enforcement, prisons, mental health
Illinois	53.9	K-12 education, income assistance, medical benefits for the needy
Indiana	91.9	Reductions are targeted
Iowa	47.5	K-12 education, local aid, entitlements
Maine	160.0	Debt service
Maryland	179.8	Prisons, Medicaid, human resources
Massachusetts	850.0	No generic program areas are exempt
Michigan	750.0	K-12 education, higher education, revenue sharing
Minnesota	197.0	No exemptions
Mississippi	105.0	Medicaid
Missouri	136.9	K-12 education, AFDC, adult basic education, entitlements, certain mental health programs, student financial aid
New Hampshire	50.0	Direct aid to local government, federal programs
New Jersey	600.0	Direct care programs (e.g., human services institutions, corrections, Medicaid)
New York	816.0	Debt service, pledged revenues associated with bond issues
North Carolina	222.2	No exemptions
Ohio	220.6	Human services, education, corrections, revenue-generating programs
Pennsylvania	358.0	No exemptions
Rhode Island	144.3	Core safety net programs such as cash assistance
South Carolina	132 6	Reductions are targeted
Tennessee	201.0	K-12 education, Medicaid
Vermont	40.0	Entitlement programs, education, property tax relief
Virginia	731.2	Aid to individuals, debt service
Total	$8,038.4	

* Includes cuts recommended but not yet implemented.
SOURCE: National Association of State Budget Officers

program with federal regulations attached to it. In other states, programs like education may be a high priority and therefore not subject to reduction.

What particular actions are states taking to balance to their budgets? Appendix Table A-9 lists strategies states have implemented or are considering. Only five states plan to close their fiscal 1991 budget gaps through tax increases. The most widely used strategies are targeted reductions (24 states), hiring freezes (22 states), and travel freezes (19 states). In and of themselves, freezes do not generate large savings and are seldom the sole options implemented in a cutback environment.

Targeting reductions to specific programs and agencies allows the Governor to protect programs that he or she deems to be of relatively high priority. In general, targeted reductions take slightly longer to implement since they reflect judgments of the relative worth of programs and therefore may require additional analysis.

Other strategies that states are pursuing include:

- **Across-the-board cuts**. These impose a fixed percentage cut on all state agencies.
- **Layoffs and furloughs**. These involve removing personnel from the state workforce (layoffs) or having state employees take a specified number of days off without pay (furloughs). In New York, employees will work five days without pay in fiscal 1991, with the understanding that they will receive full compensation when they leave state employment.
- **Revenue or tax increases**. These can range from raising fees for services, such as vehicle registration or use of state parks, to increasing taxes.
- **Delay spending**. This can include postponing projects until the next fiscal year or delaying payments to vendors or local governments.
- **Borrowing/bonding**. This can mean two things. Either the state will begin to sell bonds to finance capital spending that is currently funded by general funds or the state will sell bonds to finance its operating deficit.
- **Rainy day funds**. These funds, also known as budget stabilization funds, are established when state revenues are strong to provide a cushion when revenues are weak. States that hold balances in such funds may decide to tap those balances.
- **Reduce/delay pension contributions**. Some states have changed the assumptions for earnings in their state pension funds. This allows them to make smaller state contributions based on the assumption that the rate of earnings of the fund will be higher than previously assumed. Delaying pension contributions is a specific example of deferred spending.

Other Expenditure Issues

Aid to Families with Dependent Children. This survey has followed cost-of-living increases for Aid to Families with Dependent Children (AFDC) for the last few years. The decline in state fiscal condition is reflected in the small number of states proposing increases for fiscal 1992. Whereas twenty-four states increased benefits in fiscal 1991 and twenty-nine increased them in fiscal 1990, this year only twelve Governors have proposed increases. The states where increases have been proposed and the size of the proposed increases are listed on Table 4.

Employee Compensation Increases. More than in previous years, bargaining agreements between states and their employees are still under discussion or being renegotiated. In many states, no pay increases have been recommended for state employees. Appendix Table A-8 lists proposed increases in employee compensation for fiscal 1992.

Table 4
PROPOSED COST-OF-LIVING INCREASES FOR AID TO FAMILIES WITH DEPENDENT CHILDREN, FISCAL 1992

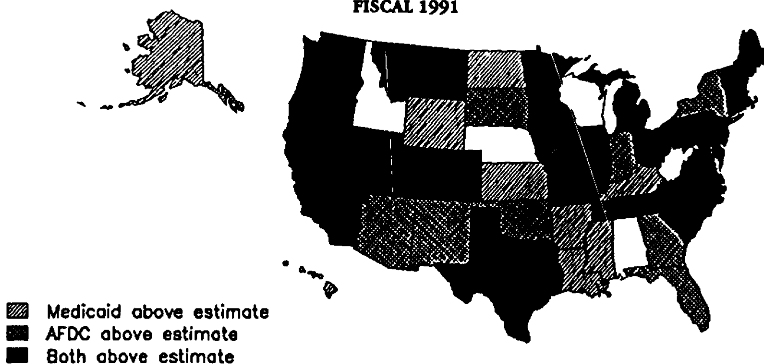
State	*Proposed 1992*	*State*	*Proposed 1992*
Alaska	12.9%	Ohio	1.4%
Arizona	14.0	Oregon	1.6
Hawaii	1.0	South Dakota	5.0
Kansas	7.9	Tennessee	3.8
Nevada*	12.7	Utah	3.0
North Dakota	5.0	Washington	4.4

NOTES: Nevada increased its payment from $330 to $370 for those not in public housing.
SOURCE: National Association of State Budget Officers

Aid to Local Government. One of the first cuts states are assumed to make when their budgets are out of balance is aid to local governments. Since this is one of the few spending areas that is largely discretionary, it is often the first to reflect the effects of a weakening state economy. Table 5 reveals the extent to which Governors' are still proposing programs to assist local governments. In a few cases an increase in state aid accompanies an increase in local responsibilities.

Medicaid and AFDC Spending. Although relatively few states are considering increases in AFDC payment levels, states continue to feel the stress of caseload increases and expenditure growth in both AFDC and Medicaid. Figure 2 identifies states that will spend more on AFDC or Medicaid than was originally budgeted for fiscal 1991. Forty-five states will spend more on one or both of the two programs than was originally budgeted and twenty-eight states will exceed their original spending estimates for both programs. Since these programs often are exempted from budget cuts, their high rate of spending growth forces even larger cuts in programs that are not exempted.

Figure 2
MEDICAID AND AFDC SPENDING COMPARED WITH ORIGINAL ESTIMATES, FISCAL 1991



Medicaid above estimate
AFDC above estimate
Both above estimate

SOURCE: National Association of State Budget Officers

Table 5
PROPOSED NEW SPENDING OR TAX PROGRAMS TO AID LOCAL GOVERNMENT, FISCAL 1992

Alaska	The capital project matching grant program will provide state capital appropriations based on a formula that incorporates a partial match from local communities.
Arkansas	Governor proposed establishing an education trust fund financed with a half-cent increase in the state sales tax rate and extension of the sales tax to the trade difference on vehicles. This will provide $102.8 million to local school districts for education.
California	The Governor has proposed several programs including a $942 million shift of specified mental health and public health programs to counties with an equivalent increase in the vehicle license fee and alcohol tax to fund these or other programs according to county priorities. Another proposal would facilitate passage of bonds for school and criminal justice facilities by lowering the approval requirement from two-thirds to one-half of the voters. Counties would be authorized to increase the sales tax by up to a half cent for drug enforcement and crime prevention purposes. Distribution of growth in sales tax revenues would be on a per capita rather than situs basis to promote greater interjurisdictional equity and better land use decisions. The Governor also has promised to veto any unfunded state mandates and has expressed commitment to eliminate or amend state required programs that are no longer effective or can be demonstrated to unreasonably limit local government decision making.
Connecticut	The Governor has proposed dedicating 2 cents per gallon of the motor fuels tax for local government expenditure on roads and bridges.
Florida	A program to provide revenue flexibility at the local level is under study.
Georgia	The Governor increased the loan program to local governments for water and sewer needs from $20 million to $50 million.
Idaho	The Governor has proposed $10 million in one time property tax relief and $4 million to begin replacing the county medically needy program with a statewide program.
Illinois	The Governor recommends a permanent increase in the dedicated allocation to local government from one-twelfth to one-ninth of net income.
Kansas	The Governor's proposal to broaden the sales tax base is intended to provide property tax relief through increased aid to school districts, assumption of the cost of certain education programs, and enhancement of some direct aid programs. Local option sales taxes also are proposed.
Maryland	The Governor has recommended that the state assume all operations and responsibilities of the Baltimore City jail. The Governor has supported a tax restructuring plan that would make the state's tax system more equitable and progressive and that would result in a $400 million increase in net new local revenues.
Minnesota	The Governor's recommendations will continue the state takeover of local costs associated with income maintenance and court operations enacted in 1989. General local government aid and other property tax relief paid directly to local governments will, however, be reduced and converted to income-related property tax refunds to homeowners.
Montana	The "Big Sky" dividend program would provide up to $29 million in coal trust fund revenues for local government infrastructure improvement grants.
Nevada	The state is transferring responsibility for some of its optional long-term care programs to counties since federal mandates have forced the state to cover recipients (particularly pregnant women and children) who were formerly a county responsibility.

Table 5 (continued)
PROPOSED NEW SPENDING OR TAX PROGRAMS TO AID LOCAL GOVERNMENT, FISCAL 1992

State	Program
New Jersey	Based on the income tax increase that took effective January 1, 1991, the state will increase aid to school districts ($1.2 billion), increase homestead rebates ($296.4 million), take over county and local costs related to the operation of state mental hospitals and developmentally disabled centers ($128.6 million), take over welfare payments ($94.3 million), take over county mental hospitals ($40.9 million), and take over out-of-home placements ($25.2 million).
New York	The Governor has proposed several programs including enhanced local revenue authority ($875 million), a Medicaid cost containment package ($105.7 million), mandate relief ($391 million), an environmental infrastructure fund ($190 million), a transportation fund ($500 million), and sales tax base broadeners ($29.5 million).
North Carolina	The Governor recommends that local governments be granted the option to levy a half-cent sales tax in lieu of a state appropriation for local aid. A bond referendum also is proposed.
North Dakota	By statute, 12 percent of all sales tax collections go to aid local government. For the 1991-93 biennium this amounts to $63 million. The Governor recommends that $6.25 million of the $63 million ' e used at the state level by the Department of Human Services to avoid shifting costs to counties for human service programs.
Oklahoma	The Governor's proposals include new funds for local economic development grants.
Oregon	The Governor proposes to use $20 million of cigarette tax revenue to fund a light rail project (one-time).
Tennessee	The Governor's education reform package includes a new Basic Education Program for K-12 education with a 70/30 state/local match, a tax equalization formula, and a 27 percent increase in first-year funding.
Wyoming	The Governor recommends an increase in the number of education classroom units and, consequently, in state funding for local schools. He also recommends $1.8 million for a 4.3 percent salary increase for community colleges.

SOURCE: National Association of State Budget Officers

7

II. State Revenue Developments

Overview

Much of current state fiscal troubles are due to weak revenue growth. Twenty-nine states estimate that their tax collections for the current year will be lower than the estimates they used in formulating their budgets. States now estimate that fiscal 1991 revenues will grow by 5.1 percent over fiscal 1990 revenues and that fiscal 1992 revenues will grow by 6.3 percent. The 1992 increase incorporates tax increases amounting to $6.6 billion, though some of these new revenues will not be credited to state general funds. Table 6 places proposed 1992 revenue increases in historical perspective.

Table 6
STATE REVENUE INCREASES, FISCAL 1978 TO FISCAL 1992

Fiscal Year	*Revenue Increase ($ in billions)*	*Fiscal Year*	*Revenue Increase ($ in billions)*
1992	$6.7 (est.)	1984	$10.1
1991	10.3	1983	3.5
1990	4.9	1982	3.8
1989	0.8	1981	0.4
1988	6.0	1980	-2.0
1987	0.6	1979	-2.3
1986	-1.1	1978	0.5
1985	0.9		

SOURCES: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1985-86 Edition*, page 77, based on data from the Tax Foundation and the National Conference of State Legislatures. Fiscal 1988, 1989, 1990, and 1991 data provided by the National Association of State Budget Officers.

Revenue Collections for Fiscal 1991

The three major state tax sources--personal income taxes, sales taxes, and corporate income taxes--are performing below expectation for many states. All three have generated less revenue than they originally estimated for fiscal 1991. Appendix Table A-2 lists current state estimates for total general fund revenues for fiscal 1992, and A-6 lists current estimates and original estimates for each of these three taxes for each state.

Of the three, the corporate income tax continues to be the weakest, with thirty-one out of forty-six states reporting collections below estimates. Since the corporate tax is frequently the first tax to reveal weakness in the underlying economy, it is not surprising that most states are having to reduce their original estimates. Twenty-seven out of forty-two states have reduced their personal income tax estimates and twenty-four out of forty-five have reduced their sales tax estimates.

Only thirteen states report that revenue collections are higher than estimated this year. All but one are located west of the Mississippi River. This confirms that eastern states continue to be more negatively affected by the national recession than western states. In particular, the Rocky Mountain and Plains states exhibit strength, with the majority of states in these regions reporting stronger-than-anticipated revenue growth.

Fiscal 1992 Tax Changes

Tax activity in fiscal 1991 was significant, with twenty-six states increasing net taxes by $10.3 billion. Most of that activity was centered in northeastern states, with three states in that area accounting for almost half of the increase. Table 7 summarizes state revenue proposals for fiscal 1992 and Appendix Table A-7 provides additional detail on specific changes Governors have recommended.

Given the high level of tax activity in fiscal 1991 and the perception that voters are unwilling to support higher state taxes, there has been some doubt as to whether states would seek to address current budget difficulties through tax increases. The answer to this question is still uncertain.

Although revenue proposals for fiscal 1992 total $6.6 billion, activity is again focused on a handful of states. Three northeastern states--Connecticut, New York, and Pennsylvania--account for half of the total proposed increase. Also, the level of proposed tax increase is less than the amount of budget cuts enacted. Thus, revenue increases are playing a smaller role in budget balancing than might be expected.

In all, twenty-three states have proposed net tax increases and none have proposed net decreases. The majority of activity is proposed in sales taxes (twelve states), miscellaneous taxes and fees (twelve states), and personal income taxes (eleven states).

Sales Tax

The net increase from sales tax proposals totals $523.6 million in fiscal 1992. This number reflects a $933.2 million reduction in Connecticut's sales tax that would be offset by the introduction of a broad-based income tax. The Governor's proposal would reduce the state sales tax rate from 8 percent to 4.25 percent.

The largest sales tax increase proposal comes from Kansas, where the Governor has proposed eliminating several exemptions to the sales tax, expanding the tax base, and increasing revenues by $478.4 million in fiscal 1992. There is also a proposal to introduce a sales tax in Oregon, but this was not a component of the Governor's budget proposal.

In Tennessee, a major tax reform package has been proposed that would introduce a state personal income tax and roll back the combined state and local sales tax rate from 8.25 percent to 6 percent. The sales tax revenue impact associated with this proposal is not yet available.

Personal Income Tax

The personal income tax is the single largest source of tax increase proposals for fiscal 1992. It accounts for more than 37 percent of total proposed revenue increases. A proposal to introduce an income tax in Connecticut would increase state revenues by $1.8 billion. This represents almost three-fourths of total proposed income tax increases.

Another significant income tax proposal has been made in Tennessee, where a broad-based income tax does not currently exist. This proposal is part of a broader tax reform package that would increase total state revenues by $702 million in fiscal 1992. The portion of the increase attributable to the introduction of an income tax is not yet available, but would potentially rival the magnitude of the Connecticut increase.

Corporate Income Tax

There is little action in the area of corporate tax increases. An initiative to increase Pennsylvania's tax by 2 percent would increase state revenues by $334 million. This represents the vast majority of proposed net increases totaling $346.4 million. Connecticut's tax reform proposal contains the only proposed corporate income tax decrease.

Table 7

SUMMARY OF PROPOSED FISCAL 1992 REVENUE INCREASES BY TYPE OF REVENUE AND NET INCREASE OR DECREASE*

($ in millions)

State	*Sales*	*Personal Income*	*Corporate Income*	*Cigarette/ Tobacco*	*Motor Fuels*	*Alcohol*	*Others*	*Total*
Alabama								0.0
Alaska								0.0
Arizona								0.0
Arkansas	170.0	-14.2						155.8
California	283.0	370.0				17.0	85.0	755.0
Colorado								0.0
Connecticut	-933.1	1,834.0	-55.0		30.5			876.4
Delaware								0.0
Florida	55.9						332.9	388.8
Georgia								0.0
Hawaii								0.0
Idaho					35.0		29.0	64.0
Illinois								0.0
Indiana								0.0
Iowa				25.6		2.4		28.0
Kansas	478.4					-		478.4
Kentucky								0.0
Louisiana								0.0
Maine	10.0	6.0	21.7				26.3	64.0
Maryland								0.0
Massachusetts								0.0
Michigan							101.0	101.0
Minnesota	3.0	36.0	3.0	77.0		11.0		130.0
Mississippi								0.0
Missouri								0.0
Montana		9.9					-4.2	5.7
Nebraska								0.0
Nevada				20.7			136.5	157.2
New Hampshire					5.0			5.0
New Jersey								0.0
New Mexico								0.0
New York	69.0		25.0		500.0		189.0	783.0
North Carolina						4.6		4.6
North Dakota								0.0
Ohio	61.3	31.2	1.7	3.8				98.0
Oklahoma								0.0
Oregon		70.0	11.0	-10.4			0.4	71.0
Pennsylvania	288.0		334.0	300.0			773.0	1,695.0
Rhode Island		102.0	5.0		20.4			127.4
South Carolina								0.0
South Dakota								0.0
Tennessee#		+						703.0
Texas							500.0	500.0
Utah								0.0
Vermont	38.1	37.4		2.7				78.2
Virginia								0.0
Washington							96.4	96.4
West Virginia								0.0
Wisconsin								0.0
Wyoming								0.0
Total	$523.6	$2,482.3	$346.4	$419.4	$590.9	$35.0	$2,265.3	$6,662.9

* See Table A-7 for details on specific revenue increases.

Taxes proposed to increase or decrease are shown with the direction of the change. Specific numbers are not yet available.

Cigarette and Tobacco Taxes

The federal government adopted a cigarette tax increase that incorporates two increases — one effective in December 1990 and the other in December 1991. A number of state officials argued at that time that federal increases in this tax would make it more difficult for states to increase the cigarette tax.

That concern is borne out in 1992 tax proposals. Whereas states raised cigarette taxes by more than $500 million in fiscal 1991, proposals for 1992 total $419.4 million, of which more than 70 percent comes from Pennsylvania. There, a proposal to raise the tax by 30 cents per pack would increase state revenues by $300 million. In all, only seven states are considering cigarette tax increases.

Motor Fuel Taxes

The federal government also raised motor fuel taxes in December 1990. As with the cigarette tax, federal increases have coincided with reduced state activity in this tax area. Only five states have proposed gasoline tax increases and New York accounts for $500 million of the total $590.9 million proposed. In fiscal 1991, state gasoline tax increases amounted to more than $1.4 billion.

Alcohol Taxes

Alcohol taxes are the last shared tax that the federal government raised in 1990. Again, the impact of federal increases on state action is apparent. Only four states have proposals to increase alcohol taxes and these proposals total just $35 million. This compares with increases of nearly $200 million in fiscal 1991.

Miscellaneous Taxes

Miscellaneous tax and revenue increases represent the growth area of state taxation. As public reluctance to support sales and income tax increases grows, states have begun to focus their efforts on increasing other areas of the state tax base. As a result, taxes and fees in this category are proposed to increase by more than $2.2 billion. Revenues included in this category include vehicle registration fees, franchise taxes, and bank taxes.

III. Year-End Balances

Total state balances are the best measure of a state's fiscal condition. These balances measure the amount of resources states have available to use if the condition of the economy declines. In general, state balances grow during periods of economic expansion and decline during periods of economic contraction (see Table 8).

During the most recent business cycle, state balances peaked in 1989, when they totaled $12.5 billion and represented 4.8 percent of total state general fund expenditures. Since then, balances have been steadily and rapidly declining and are estimated to be just $5.9 billion at the close of fiscal 1991, or less than half their level of two years earlier.

Table 8
SIZE OF TOTAL YEAR-END BALANCES, FISCAL 1979 TO FISCAL 1992

Fiscal Year	*Total Balance ($ in billions)*	*Total Balance (As % of Expenditures)*
1992	$6.1 (est.)	2.0%
1991	5.9 (est.)	2.0
1990	10.2	3.7
1989	12.5	4.8
1988	9.8	4.2
1987	6.7	3.1
1986	7.2	3.5
1985	9.7	5.2
1984	6.4	3.8
1983	2.3	1.5
1982	4.5	2.9
1981	6.5	4.4
1980	11.8	9.0
1979	11.2	8.7

SOURCE: National Association of State Budget Officers

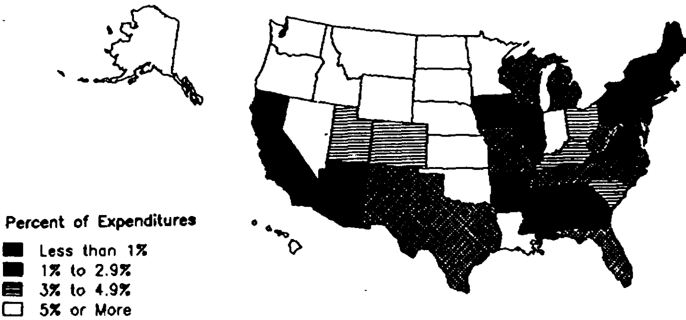
When fiscal 1991 budgets were originally enacted, total state balances were estimated at $7.4 billion. A decline of $1.5 billion between enactment and current estimates reflects a decline in the national economy that is forcing states to utilize their reserves. Based on current estimates, reserves will represent only 2.0 percent of total state expenditures for the current year.

Fiscal 1992 looks no better. While reserves are proposed to increase to $6.2 billion, they will still represent only 2.0 percent of state spending. If the national recession persists, this level of balances will probably prove to be too optimistic.

Alaska serves to bolster state balances considerably. A robust state economy has greatly expanded its reserves so that its total balances for fiscal 1991 are estimated at 77.8 percent of state spending. For fiscal 1992, balances are estimated at 64.2 percent of expenditures.

Because Alaska's economy is so volatile, it is sometimes removed from national totals on state fiscal condition. Excluding Alaska, state balances for fiscal 1991 decline to only $4.3 billion, or 1.5 percent of state spending. For 1992, they drop to $4.7 billion, or 1.6 percent of state spending.

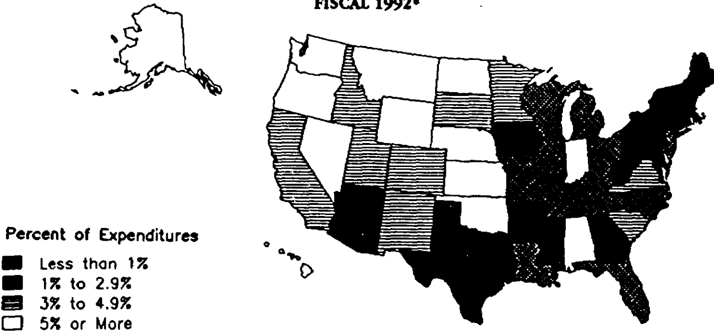
Figure 3
TOTAL YEAR-END BALANCES AS A PERCENT OF EXPENDITURES, FISCAL 1991



SOURCE: National Association of State Budget Officers

Figure 3 and Figure 4 show the distinction between the fiscal condition in the East and the West. While few states east of the Mississippi River hold balances greater than 5 percent of expenditures, several west of the Mississippi River do. The South is the area with the greatest variation in state fiscal condition. A continued decline in the national economy could accelerate the spread of poor fiscal conditions, though fiscal 1992 budgets do not reflect this.

Figure 4
TOTAL YEAR-END BALANCES AS A PERCENT OF EXPENDITURES, FISCAL 1992*



*Data for Alabama and Rhode Island are not available.
SOURCE: National Association of State Budget Officers

Table 9 shows the decline in fiscal condition since 1990. Many states had budget problems in fiscal 1990, and ten ended the year with balances of less than 3 percent of expenditures. As the national recession set in, the number of states holding balances this low increased. The number is expected to nearly double in fiscal 1991.

The table shows a significant split in state fiscal conditions. Few states hold balances in the middle ranges in fiscal 1991, while nineteen (including almost every northeastern state) hold less than 1 percent and seventeen (predominantly western states) hold 5 percent or more. Delaware is the only northeastern state that has managed to maintain a balance of more than 5 percent throughout this downturn.

In 1992 state fiscal conditions will begin to equalize. Fewer states anticipate holding balances below 1 percent and fewer anticipate holding 5 percent or more. Consequently, the number of states holding balances in the middle ranges increases. Total state balances remain unchanged from fiscal 1991, at 2.1 percent.

How does the current condition of state balances compare with the recession of the early 1980s? Total balances for fiscal 1991, excluding Alaska's large surplus, represent the same percentage of expenditures as balances in 1983, the last year of a long and deep recession. Including Alaska's surplus, both fiscal 1991 and fiscal 1992 balances register 2.0 percent of expenditures, the lowest percentage since 1983.

Table 9
TOTAL YEAR-END BALANCES AS A PERCENT OF EXPENDITURES, FISCAL 1990 TO FISCAL 1992

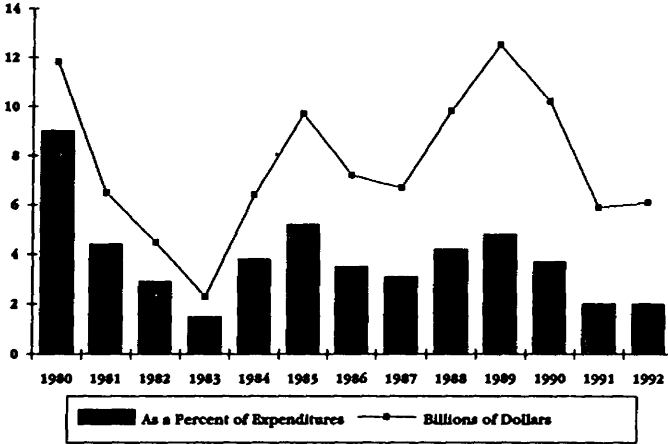
	Number of States		
Percentage	*Fiscal 1990 (Actual)*	*Fiscal 1991 (Estimated)*	*Fiscal 1992 (Proposed)*
Less than 1.0%	10	19	15
1.0% to 2.9%	10	9	11
3.0% to 4.9%	7	5	9
5% or More	23	17	13
Average Percent	**3.7%**	**2.0%**	**2.0%**

SOURCE: National Association of State Budget Officers

Figure 5 graphically illustrates of the impact of the national economy on state budgets. The dramatic decline in balances during the 1980-83 period is paralleled in 1989-92. While the dollar level of state balances is higher now than it was in the early 1980s, the percent of state spending those balances represent is roughly the same.

Only six months into this recession, states are at nearly the same level of distress as they were after more than a year of recession in fiscal 1983. Clearly, the pressures on state spending from programs like Medicaid make states much more vulnerable to this recession than to the last one. If the recession persists well into fiscal 1992, the levels of state budget cuts, tax increases, and balances are likely to be far worse than they are now estimated to be.

Figure 5
SIZE OF TOTAL YEAR - END BALANCES,
FISCAL 1980 TO FISCAL 1992



SOURCE: National Association of State Budget Officers

IV. Regional Fiscal Outlook

Overview

The strong regional patterns of state fiscal decline are beginning to blur but have not disappeared. Western states continue to outperform the national average with the exception of California, where significant budget problems have emerged over the last few years. The Plains and Rocky Mountain regions are the strongest, with both the lowest unemployment rates and the highest balances in the country. For the third year in a row, New England continues to have the weakest performance.

The data in Table 10 reveal an overall weakening in the economy. Each of the variables shown has declined since this report was last published. Unemployment is higher, and income growth, population growth, balances, and budget growth are all lower than they were six months ago.

Table 10
REGIONAL BUDGET AND ECONOMIC INDICATORS

Region	*Weighted Unemployment Rate*[a]	*Annual % Change in Personal Income*[b]	*Annual % Change in Population*[c]	*Fiscal 1991 Total Balances as a Percent of Expenditures*	*Proposed 1992 General Fund Budget Growth (%)*	*Number of States in Region*
New England	6.1%	3.3%	1.5%	-3.2%	2.4%	6
Mideast	5.5	5.6	0.2	-0.3	4.8	5
Great Lakes	5.7	5.5	-0.3	2.6	1.7	5
Plains	5.0	6.2	-0.7	5.5	5.2	7
Southeast	5.9	7.2	0.3	1.9	5.0	12
Southwest	6.4	7.3	0.5	3.0	15.1	4
Rocky Mountain	4.6	7.1	-0.2	6.3	4.8	5
Far West	6.2	7.4	2.7	4.1	3.6	6
Average	**5.8%**	**6.3%**	**0.6%**	**2.0%**	**4.8%**	**50**

SOURCES:
a. U.S. Department of Labor, Bureau of Labor Statistics, February 1990.
b. Survey of Current Business, January 1991, 1989.3-1990.3, p. 41.
c. FFIS Issue Brief 90-21, Population of the States and Regions, 1989-1990, p.2.

New England

The situation in New England remains roughly the same. A few states had budget troubles in fiscal 1988, several had them in fiscal 1989, and every state has struggled in both 1990 and 1991. Whereas this region had distinctly lower unemployment rates and higher income growth rates than the rest of the country throughout the mid-1980s, it now underperforms the nation in both areas. Three of the six states in the region will end fiscal 1991 with deficits and 1992 budget growth is estimated at just half the national average.

Mideast

This region followed New England in entering a recession. By fiscal 1990 almost every state was dealing with budget imbalances, and in fiscal 1991 every state has taken action to balance its budget.

Only one state, Delaware, plans to have a significant balance at the end of fiscal 1991. Like New England, unemployment rates and personal income growth in the Mideast have worsened relative to the national average over the last few years. Budget growth for 1992 equals the national averages of 4.8 percent.

Great Lakes

The Great Lakes region is the latest to slip into a recession. Whereas fiscal 1990 balances were estimated at 6.2 percent in the last survey, fiscal 1991 balances are now estimated at just 2.6 percent. Only Michigan had to take action to reduce its 1990 budget, while every state in the region has reduced its 1991 budget. Fiscal 1992 budget growth is estimated at just 1.7 percent, the lowest growth rate in the country. This reflects few proposals to increase revenues and the resulting need to restrain spending growth in order to maintain balanced budgets. It also reflects a reduction in balances available to finance expenditure growth.

Plains

Although the economic indicators in the Plains region have declined since the last survey, the region now, as then, continues to outperform other regions. It has the second lowest unemployment rate in the nation and is the only region to hold more than 5 percent of expenditures in balances. In fact, three of the seven states will hold balances of more than 10 percent at the end of the year. Fiscal 1992 spending growth, at 5 percent, exceeds the national average but is moderate relative to spending growth over the last few years. Like the Great Lakes and Rocky Mountain regions, the Plains region has experienced a decline in population over the last year.

Southeast

This is a region full of variety. Because it encompasses twelve states, it is difficult to generalize about the Southeast. Only one state in the region, Louisiana, plans to hold balances of more than 5 percent of expenditures at the end of fiscal 1991 and most of the states in the region will hold closer to 1 percent. The region's unemployment rate and expenditure growth rate are approximately the national average, while personal income growth rate exceeds the national average. Five states in the region have proposed spending growth for fiscal 1992 that exceeds 5 percent and one, Virginia, has proposed spending that is lower than fiscal 1991.

Southwest

Economic indicators for the Southwest tend to be carried by Texas, since it is by far the largest of the four states in the region. The region shows the highest spending growth for fiscal 1992, but this is due to proposed growth of more than 21 percent in Texas, where education funding reform is placing significant pressure on state spending. The other three states in the region plan to increase spending by 4.5-5.1 percent. While the region plans to hold balances of 3 percent of expenditures in fiscal 1991, in 1992 balances will decline significantly as Texas struggles with balancing its budget.

Rocky Mountain

Like the Plains region, the Rocky Mountain region continues to exceed the economic performance of the nation while losing population. As a region it plans to hold the highest percentage of spending in balances at the end of fiscal 1991. It also has the lowest unemployment rate in the country. For fiscal 1992, spending growth in the Rocky Mountains is estimated at 4.8 percent, exactly the national average. This average masks a very high increase in Montana (25.4 percent) and a decrease in Wyoming (-4.1 percent).

Far West

As Texas dominated the Southwest, so California dominates the Far West region. In the current year, this serves to paint a far more pessimistic picture of the region than would exist if California were excluded from region totals. For example, a $700 million deficit in California at the end of the year pulls the region's balances down to 4.1 percent of expenditures. In fact, every other state in the region will hold more than 5 percent in balances. Alaska's fortunes are as bright as California's are bleak. It's balances at the end of fiscal 1991 will represent almost 78 percent of expenditures. The region continues to show the strongest population and personal income growth in the nation. On the other hand, its proposed spending growth for fiscal 1992 is only 3.6 percent, below the national average of 4.8 percent.

NOTES TO TABLE A-1

For all states, unless otherwise noted, transfers into budget stabilization funds are counted as expenditures and transfers from budget stabilization funds are counted as revenues.

Colorado	Ending balance includes required reserve of $99.1 million.
Delaware	Ending balance includes budget stabilization fund of $ 62.5 million.
Florida	Ending balance includes reserve of $163.3 million.
Maryland	Ending balance includes budget stabilization fund of $118.1 million.
Minnesota	Ending balance includes budget stabilization fund of $550 million.
Montana	Revenues include adjustments.
New Hampshire	Revenues include transfer from budget stabilization fund.
New Jersey	Figures include property tax relief fund.
New Mexico	Ending balance is held in a budget stabilization fund.
New York	Revenues reflect a $460 million reduction for impoundment of 1988-89 deficit notes and receipt of $775 million in proceeds from 1989-90 deficit notes.
North Carolina	Revenues include tax and non-tax revenues, transfers, and bonding. The ending balance includes $141 million budget stabilization fund.
Oklahoma	Expenditures include transfer to budget stabilization fund.
Oregon	Expenditure information has been estimated by assuming 48 percent of the budget is spent in the first fiscal year of the biennium and 52 percent is spent in the second year. Year-to-year comparisons of this information may be misleading.
Pennsylvania	Revenues include $112 million in lapses. In addition to its budget stabilization fund, Pennsylvania has a $58 million "sunny day fund" for economic development.
South Carolina	Ending balance includes $88 million budget stabilization fund.
Tennessee	Ending balance includes $100 million budget stabilization fund.
Vermont	Deficit was eliminated through transfer of $2.6 million from the budget stabilization fund.
Virginia	Ending balance represents the undesignated fund balance.
Wisconsin	Ending balance represents the undesignated fund balance.

APPENDIX

Table A-1
FISCAL 1990 STATE GENERAL FUND, ACTUAL
($ in millions)

Region/State	Beginning Balance	Revenues	Resources	Expenditures	Ending Balance	Budget Stabilization Fund
NEW ENGLAND						
Connecticut	$0	$6,112	$6,112	$6,372	-$260	$102
Maine	169	1,500	1,669	1,608	61	1
Massachusetts	147	10,266	10,413	11,692	-1,279	
New Hampshire*	6	591	596	607	-11	
Rhode Island	14	1,476	1,489	1,489	0	6
Vermont*	11	576	587	590	-3	12
MIDEAST						
Delaware	185	1,157	1,342	1,170	172	*
Maryland	390	5,707	6,098	6,041	57	*
New Jersey*	411	11,400	11,812	11,811	1	
New York*	0	29,229	29,229	29,229	0	
Pennsylvania*	385	11,571	11,956	11,820	136	127
GREAT LAKES						
Illinois	541	12,841	13,382	12,987	395	
Indiana	425	5,459	5,884	5,512	372	318
Michigan	61	7,446	7,507	7,817	-310	386
Ohio	475	9,382	9,857	9,412	445	364
Wisconsin*	375	5,751	6,126	5,820	306	
PLAINS						
Iowa	95	2,828	2,923	2,852	72	
Kansas	373	2,301	2,673	2,400	273	
Minnesota	946	6,631	7,577	6,692	885	*
Missouri	110	4,050	4,160	4,103	57	
Nebraska	290	1,163	1,453	1,194	259	40
North Dakota	40	543	583	529	54	21
South Dakota	39	444	484	446	38	
SOUTHEAST						
Alabama	53	3,232	3,285	3,220	65	33
Arkansas	0	1,812	1,812	1,812	0	
Florida	199	10,003	10,202	9,947	255	*
Georgia	224	7,196	7,420	7,363	57	
Kentucky	48	3,573	3,621	3,533	87	
Louisiana	655	4,386	5,041	4,339	702	
Mississippi	84	1,850	1,934	1,929	5	17
North Carolina*	157	6,988	7,145	6,923	222	*
South Carolina	217	3,326	3,543	3,407	136	*
Tennessee	228	3,682	3,910	3,742	168	*
Virginia*	0	5,273	5,273	5,273	0	
West Virginia	66	1,746	1,812	1,712	100	
SOUTHWEST						
Arizona	1	3,095	3,097	3,062	34	
New Mexico	0	1,783	1,783	1,780	*	108
Oklahoma*	157	2,697	2,854	2,707	147	151
Texas	187	13,927	14,114	13,647	467	19
ROCKY MOUNTAIN						
Colorado	134	2,484	2,619	2,485	134	*
Idaho	77	857	934	884	50	35
Montana*	67	454	521	432	89	
Utah	71	1,630	1,701	1,624	77	52
Wyoming	54	363	417	317	101	35
FAR WEST						
Alaska	167	2,501	2,668	2,368	300	867
California	1,252	38,750	40,002	39,455	547	
Hawaii	629	2,452	3,081	2,625	456	
Nevada	27	812	839	763	76	40
Oregon*	298	2,217	2,515	2,188	327	
Washington	518	6,517	7,035	6,136	899	260
TOTAL	$11,059	$272,030	$283,089	$275,865	$7,221	$2,995

Table A-2
FISCAL 1991 STATE GENERAL FUND, ESTIMATED
($ in millions)

Region/State	*Beginning Balance*	*Revenues*	*Resources*	*Expenditures*	*Ending Balance*	*Budget Stabilization Fund*
NEW ENGLAND						
Connecticut	-$157	$6,042	$5,885	$6,593	-$707	
Maine	61	1,570	1,631	1,627	4	1
Massachusetts	-1,279	12,604	11,325	11,279	46	
New Hampshire	-11	635	624	624	0	
Rhode Island	0	1,428	1,428	1,450	-22	
Vermont*	0	601	601	630	-29	8
MIDEAST						
Delaware	172	1,156	1,328	1,223	105	*
Maryland	57	5,904	5,961	5,959	2	*
New Jersey*	1	12,217	12,218	12,217	1	
New York*	0	29,204	29,204	29,204	0	
Pennsylvania*	136	11,871	12,007	12,322	-315	
GREAT LAKES						
Illinois	395	13,453	13,848	13,748	100	
Indiana	372	5,521	5,894	5,820	74	321
Michigan*	-310	7,900	7,590	7,590	0	203
Ohio	445	9,859	10,304	10,251	53	300
Wisconsin	307	6,157	6,463	6,355	109	
PLAINS						
Iowa	72	3,083	3,155	3,137	18	
Kansas	273	2,382	2,655	2,501	154	*
Minnesota	885	6,889	7,774	7,274	500	*
Missouri	57	4,276	4,333	4,280	53	
Nebraska	259	1,397	1,656	1,489	167	32
North Dakota	54	573	627	523	104	22
South Dakota	38	485	524	483	40	
SOUTHEAST						
Alabama*	65	3,382	3,447	3,450	-3	
Arkansas	0	1,862	1,862	1,862	0	
Florida	255	10,433	10,688	10,539	149	*
Georgia*	57	7,426	7,632	7,632	0	
Kentucky	87	4,381	4,468	4,286	182	*
Louisiana	702	4,233	4,935	4,498	437	
Mississippi	5	1,956	1,961	1,960	0	17
North Carolina*	222	7,647	7,869	7,762	107	
South Carolina	136	3,460	3,596	3,453	143	*
Tennessee	168	3,738	3,906	3,857	49	*
Virginia*	0	6,246	6,246	6,246	0	
West Virginia	100	1,836	1,936	1,914	21	
SOUTHWEST						
Arizona	34	3,348	3,382	3,382	0	
New Mexico*	0	1,875	1,875	1,926	-50	96
Oklahoma*	147	3,030	3,177	2,992	185	157
Texas	467	13,910	14,376	14,247	129	166
ROCKY MOUNTAIN						
Colorado*	117	2,618	2,734	2,654	80	*
Idaho	50	907	957	935	22	35
Montana	89	433	522	459	63	
Utah	76	1,685	1,761	1,745	16	56
Wyoming	101	359	460	422	38	85
FAR WEST						
Alaska	300	2,826	3,126	2,288	838	941
California	547	40,438	40,985	41,720	-735	
Hawaii	456	2,574	3,030	2,796	234	
Nevada	76	881	957	939	18	40
Oregon*	327	2,389	2,716	2,371	345	
Washington	899	6,777	7,676	7,286	390	260
TOTAL	$7,308	$285,858	$293,315	$2[illegible]0,202	$3,113	$2,740

NOTES TO TABLE A-2

For all states, unless otherwise noted, transfers into budget stabilization funds are counted as expenditures and transfers from budget stabilization funds are counted as revenues.

Alabama	Revenues include a $33.3 million transfer from the budget stabilization fund.
Colorado	Beginning balance reflects provision that 50 percent of the balance in excess of the required reserve be transferred to the capital construction fund ($134.2 - 99.1 = 35.1 X 50% = 17.5 to capital construction fund). Ending balance reflects required reserve of $80.1 million.
Delaware	Ending balance includes budget stabilization fund of $65.4 million.
Florida	Ending balance includes reserve of $148.9 million.
Georgia	Total resources include $149 million gain from cash to bond conversion.
Kansas	Figures reflect Governor's proposal. Ending balance includes a reserve of $145.1 million created by the 1990 legislature.
Maryland	Ending balance includes budget stabilization fund of $55.6 million.
Michigan	Figures reflect Governor's proposals. Ending balance would be achieved through use of $213 million budget stabilization fund, $750 million expenditure reduction, and $398 million in accounting changes and one-time revenue sources.
Minnesota	Ending balance includes budget stabilization fund of $500 million.
New Jersey	Figures include property tax relief fund.
New York	Revenues reflect a $775 million reduction for impoundment of 1989-90 deficit notes and receipt of $905 million in proceeds from planned 1990-91 deficit notes. Does not reflect the impact of Local Government Assistance Corporation bond proceeds.
North Carolina	Revenues include tax and non-tax revenues, transfers, and bonding.
Oklahoma	Expenditures include transfer to budget stabilization fund.
Oregon	Expenditure information has been estimated by assuming 48 percent of the budget is spent in the first fiscal year of the biennium and 52 percent is spent in the second year. Year-to-year comparisons of this information may be misleading.
Pennsylvania	Revenues include a $133.8 million transfer from the budget stabilization fund. Pennsylvania also has a $23 million "sunny day fund" for economic development.
South Carolina	Ending balance includes a $94 million budget stabilization fund.
Tennessee	Ending balance includes a $49 million budget stabilization fund.
Vermont	Deficit will be reduced by $8.2 million transfer from budget stabilization fund.
Virginia	Ending balance represents the undesignated fund balance.

Table A-3
FISCAL 1992 STATE GENERAL FUND, PROPOSED
($ in millions)

Region/State	*Beginning Balance*	*Revenues*	*Resources*	*Expenditures*	*Ending Balance*	*Budget Stabilization Fund*
NEW ENGLAND						
Connecticut*	$0	$6,835	$6,835	$6,835	$0	
Maine	4	1,570	1,574	1,569	5	1
Massachusetts	45	11,530	11,575	11,530	45	
New Hampshire	0	665	665	665	0	
Rhode Island			Not available			
Vermont	-21	663	642	662	-20	
MIDEAST						
Delaware	105	1,201	1,306	1,205	101	*
Maryland	2	6,512	6,514	6,512	2	*
New Jersey*	1	14,191	14,192	13,918	274	
New York*	0	29,189	29,189	29,145	*	44
Pennsylvania*	-315	13,407	13,092	13,090	2	42
GREAT LAKES						
Illinois	100	14,278	14,378	14,178	200	
Indiana	74	5,703	5,777	5,741	36	331
Michigan*	0	8,073	8,073	8,057	16	218
Ohio	53	10,192	10,245	10,179	66	150
Wisconsin	109	6,361	6,470	6,367	103	
PLAINS						
Iowa	18	3,345	3,363	3,358	5	
Kansas	154	2,956	3,110	2,902	208	*
Minnesota	500	7,254	7,754	7,413	341	*
Missouri	53	4,445	4,497	4,442	55	2
Nebraska	167	1,454	1,621	1,489	132	32
North Dakota	104	534	638	583	55	23
South Dakota*	20	498	519	519	0	20
SOUTHEAST						
Alabama			Not available			
Arkansas	0	1,938	1,938	1,938	0	
Florida	149	11,537	11,686	11,522	163	*
Georgia	0	7,900	7,900	7,900	0	
Kentucky	182	4,541	4,723	4,676	92	*
Louisiana	437	4,168	4,605	4,554	51	
Mississippi	0	2,137	2,137	2,136	1	17
North Carolina	107	7,680	7,787	7,787	0	95
South Carolina	111	3,654	3,765	3,649	116	*
Tennessee	49	4,491	4,540	4,491	49	*
Virginia	0	6,288	6,288	6,074	214	*
West Virginia	21	1,965	1,986	1,986	1	
SOUTHWEST						
Arizona	0	3,545	3,545	3,540	5	
New Mexico	0	2,040	2,040	2,024	*	96
Oklahoma	185	3,169	3,354	3,128	226	157
Texas*	129	14,798	14,927	17,259	-2,331	181
ROCKY MOUNTAIN						
Colorado	80	2,765	2,845	2,763	82	*
Idaho	22	971	993	993	0	35
Montana	63	572	635	576	59	
Utah	15	1,762	1,777	1,777	0	60
Wyoming	38	367	405	405	1	53
FAR WEST						
Alaska*	0	2,378	2,378	2,378	0	1,526
California	-737	45,771	45,034	43,282	1,752	*
Hawaii	234	2,714	2,948	2,763	185	
Nevada	18	1,065	1,083	1,068	15	40
Oregon*	345	2,377	2,722	2,548	174	
Washington	390	7,252	7,642	7,415	227	260
TOTAL	$3,011	$298,700	$301,711	$298,989	$2,706	$3,383

NOTES TO TABLE A-3

For all states, unless otherwise noted, transfers into budget stabilization funds are counted as expenditures and transfers from budget stabilization funds are counted as revenues.

Alaska	Beginning balance reflects transfer of $838.2 million to a budget stabilization fund. Revenues include transfer of $253.5 million from this fund.
California	Ending balance includes budget stabilization fund balance of $1,401 million.
Colorado	Ending balance includes required reserve of $82 million.
Delaware	Ending balance includes budget stabilization fund of $65 million.
Connecticut	Revenues exclude $287.1 million, of which $272.1 million is being dedicated to finance the first year of a three-year deficit elimination program aimed at financing the cumulative 1990-91 deficit. The remaining $15 million is being transferred to the Department of Revenue Services for administration of the new personal income tax.
Florida	Ending balance includes reserve of $163.4 million.
Kansas	Ending balance includes reserve of $159.3 million created by the 1990 legislature.
Kentucky	In addition to the ending balance, there is $43.5 million (biennial) included in a budget stabilization fund.
Maryland	Ending balance includes budget stabilization fund of $75.4 million.
Michigan	Expenditures for fiscal 1992 are based on fiscal 1991 current services baseline reflecting the Governor's recommendations for solving the current year deficit. Revenues for fiscal 1992 reflect Governor's proposal to implement an investment tax credit to replace the Capital Acquisition Deduction (CAD) to the Single Business Tax.
Minnesota	Ending balance includes budget stabilization fund of $550 million.
New Jersey	Figures include property tax relief fund.
New Mexico	Ending balance is held in a budget stabilization fund of $95.8 million.
New York	Revenues reflect a $905 million impoundment of 1990-91 deficit notes. Ending balance is held in the tax stabilization reserve fund.
Oregon	Expenditure information has been estimated by assuming 48 percent of the budget is spent in the first fiscal year of the biennium and 52 percent is spent in the second year. Year-to-year comparisons of this information may be misleading.
Pennsylvania	In addition to its budget stabilization fund, Pennsylvania has a $3 million "sunny day fund" for economic development.
South Carolina	Ending balance includes a $99 million budget stabilization fund.
South Dakota	The Governor has introduced legislation to create a budget reserve fund in fiscal 1992. The beginning balance reflects the transfer of $20 million into this fund at the end of fiscal 1991.
Tennessee	Ending balance includes a $49 million budget stabilization fund.

Table A-4
TOTAL BALANCES AS A PERCENT OF EXPENDITURES, FISCAL 1990 TO FISCAL 1992

	Total Balances ($ in millions)			*As a Percent of Expenditures*		
Region/State	*Fiscal 1990*	*Fiscal 1991*	*Fiscal 1992*	*Fiscal 1990*	*Fiscal 1991*	*Fiscal 1992*
NEW ENGLAND						
Connecticut	-$157	-$707	$0	-2.5 %	-10.7 %	0.0 %
Maine	62	5	6	3.9	0.3	0.4
Massachusetts	-1,279	46	45	-10.9	0.4	0.4
New Hampshire	-11	0	0	-1.8	0.0	0.0
Rhode Island	6	-22	N/A	0.4	-1.5	N/A
Vermont	10	-21	-20	1.6	-3.3	-3.0
MIDEAST						
Delaware	172	105	101	14.7	8.6	8.3
Maryland	57	2	2	0.9	0.0	0.0
New Jersey	1	1	274	0.0	0.0	2.0
New York	0	0	44	0.0	0.0	0.2
Pennsylvania	263	-315	44	2.2	-2.6	0.3
GREAT LAKES						
Illinois	395	100	200	3.0	0.7	1.4
Indiana	690	395	367	12.5	6.8	6.4
Michigan	76	203	234	1.0	2.7	2.9
Ohio	810	353	217	8.6	3.4	2.1
Wisconsin	306	109	103	5.3	1.7	1.6
PLAINS						
Iowa	72	18	5	2.5	0.6	0.2
Kansas	273	154	208	11.4	6.2	7.2
Minnesota	885	500	341	13.2	6.9	4.6
Missouri	57	53	57	1.4	1.2	1.3
Nebraska	299	199	163	25.0	13.3	11.0
North Dakota	75	126	78	14.2	24.1	13.4
South Dakota	38	40	20	8.5	8.3	3.9
SOUTHEAST						
Alabama	98	-3	N/A	3.0	-0.1	N/A
Arkansas	0	0	0	0.0	0.0	0.0
Florida	255	149	163	2.6	1.4	1.4
Georgia	57	0	0	0.8	0.0	0.0
Kentucky	87	182	92	2.5	4.3	2.0
Louisiana	702	437	51	16.2	9.7	1.1
Mississippi	22	17	18	1.2	0.9	0.9
North Carolina	222	107	95	3.2	1.4	1.2
South Carolina	136	143	116	4.0	4.1	3.2
Tennessee	168	49	49	4.5	1.3	1.1
Virginia	0	0	214	0.0	0.0	3.5
West Virginia	100	21	1	5.8	1.1	0.0
SOUTHWEST						
Arizona	34	0	5	1.1	0.0	0.1
New Mexico	108	45	96	6.1	2.4	4.7
Oklahoma	298	342	383	11.0	11.4	12.2
Texas	486	296	-2,150	3.6	2.1	-12.5
ROCKY MOUNTAIN						
Colorado	134	80	82	5.4	3.0	3.0
Idaho	85	57	35	9.6	6.1	3.5
Montana	89	63	59	20.6	13.7	10.2
Utah	129	72	60	7.9	4.1	3.4
Wyoming	135	123	53	42.7	29.0	13.2
FAR WEST						
Alaska	1,167	1,779	1,526	49.3	77.8	64.2
California	547	-735	1,752	1.4	-1.8	4.0
Hawaii	456	234	185	17.4	8.4	6.7
Nevada	116	58	55	15.2	6.2	5.1
Oregon	327	345	174	14.9	14.6	6.8
Washington	1,159	650	487	18.9	8.9	6.6
TOTAL	$10,216	$5,854	$6,088	3.7 %	2.0 %	2.0 %

NOTES TO TABLE A-3(con't)

Texas	Expenditures are based on a "current services" budget prepared by the legislative budget board staff.
Virginia	Ending balance includes $200 million revenue reserve.

Table A-5
NOMINAL PERCENTAGE EXPENDITURE CHANGE
FISCAL 1991 AND FISCAL 1992

Region/State	*Fiscal 1991*	*Fiscal 1992*
NEW ENGLAND		
Connecticut	3.5 %	3.7 %
Maine	1.2	-3.6
Massachusetts	-3.5	2.2
New Hampshire	2.8	6.6
Rhode Island	-2 6	N/A
Vermont	6.9	5.0
MIDEAST		
Delaware	4.5	-1.5
Maryland	-1.4	9.3
New Jersey	3.4	13.9
New York	-0.1	-0 2
Pennsylvania	4.2	6.2
GREAT LAKES		
Illinois	5.9	3.1
Indiana	5 6	-1.4
Michigan	-2.9	6.1
Ohio	8.9	-0.7
Wisconsin	9.2	0 2
PLAINS		
Iowa	10.0	7.0
Kansas	4 2	16.0
Minnesota	8.7	1.9
Missouri	4 3	3 8
Nebraska	24 7	0.0
North Dakota	-1.1	11.5
South Dakota	8 5	7.3
SOUTHEAST		
Alabama	7.1	N/A
Arkansas	2 8	4.1
Florida	6.0	9.3
Georgia	3.7	3.5
Kentucky	21.5	9.1
Louisiana	3 7	1.2
Mississippi	1.6	9.0
North Carolina	12 1	0 3
South Carolina	1.3	5.7
Tennessee	3.1	16 4
Virginia	18.4	-2 7
West Virginia	11.8	3 7
SOUTHWEST		
Arizona	10 4	4.7
New Mexico	8.2	5.1
Oklahoma	10.5	4.5
Texas	4 4	21.1
ROCKY MOUNTAIN		
Colorado	6.8	4 1
Idaho	5.8	6 2
Montana	6.2	25.4
Utah	7.5	1 8
Wyoming	33.3	-4.1
FAR WEST		
Alaska	-3.4	3.9
California	5.7	3.7
Hawaii	6.5	-1 2
Nevada	23.1	13.7
Oregon	8.3	7.5
Washington	18.7	1.8
TOTAL	5.2 %	4.8 %

Table A-6
TAX COLLECTIONS COMPARED WITH PROJECTIONS USED IN ADOPTING FISCAL 1991 BUDGET
($ in millions)

	Sales Tax		*Personal Income Tax*		*Corporate Income Tax*		*Total*
Region/State	*Original Estimate*	*Current Estimate*	*Original Estimate*	*Current Estimate*	*Original Estimate*	*Current Estimate*	*Revenue Collection #*
NEW ENGLAND							
Connecticut*	$2,624	$2,473	$667	$621	$958	$743	L
Maine	525	470	602	573	85	79	
Massachusetts	2,163	1,869	5,342	4,995	679	555	L
New Hampshire	N/A	N/A	N/A	N/A	159	141	L
Rhode Island*	491	430	458	419	54	45	L
Vermont	130	129	296	264	27	27	T
MIDEAST							
Delaware	N/A	N/A	499	474	72	61	L
Maryland	1,701	1,580	3,136	3,019	178	132	L
New Jersey	4,605	4,140	3,862	3,862	1,085	1,085	L
New York*	6,158	5,830	15,560	14,552	1,515	1,513	L
Pennsylvania	4,477	4,303	3,512	3,470	1,128	1,073	L
GREAT LAKES							
Illinois	4,040	3,980	4,274	4,274	592	592	T
Indiana	2,326	2,236	2,204	2,174	810	653	L
Michigan*	2,919	2,773	3,771	3,692	2,022	1,895	L
Ohio	3,549	3,380	3,863	3,805	897	765	L
Wisconsin	2,114	2,045	2,965	3,000	430	430	L
PLAINS							
Iowa	757	772	1,540	1,547	267	238	L
Kansas*	854	861	892	908	170	147	H
Minnesota	1,979	1,949	2,959	2,860	412	468	L
Missouri	1,303	1,264	2,216	2,157	334	263	L
Nebraska	562	562	603	624	55	73	H
North Dakota	255	243	124	125	32	57	H
South Dakota	243	248	N/A	N/A	N/A	N/A	H
SOUTHEAST							
Alabama	830	830	1,170	1,150	190	165	L
Arkansas	853	866	882	882	143	143	T
Florida	7,495	7,046	N/A	N/A	896	810	L
Georgia*	2,731	2,759	3,107	3,029	480	460	L
Kentucky	1,305	1,305	1,757	1,757	340	340	T
Louisiana	1,444	1,472	791	803	312	355	H
Mississippi	853	853	486	459	205	165	L
North Carolina	1,801	1,739	3,891	3,706	690	614	L
South Carolina	1,205	1,198	1,513	1,477	207	152	L
Tennessee	2,458	2,400	102	111	385	313	L
Virginia	1,460	1,339	3,704	3,267	300	273	L
West Virginia	502	524	527	546	140	143	H
SOUTHWEST							
Arizona	1,498	1,452	1,231	1,202	237	188	L
New Mexico	727	731	433	398	59	40	L
Oklahoma	925	927	1,180	1,146	99	122	T
Texas*	7,764	8,154	N/A	N/A	N/A	N/A	H
ROCKY MOUNTAIN							
Colorado	767	778	1,533	1,512	165	103	L
Idaho	339	344	400	429	70	62	H
Montana	N/A	N/A	146	152	38	45	H
Utah	730	732	645	690	93	90	H
Wyoming	101	108	N/A	N/A	N/A	N/A	H
FAR WEST							
Alaska	N/A	N/A	N/A	N/A	210	210	L
California	14,485	13,830	18,709	17,620	5,905	5,370	L
Hawaii	1,143	1,162	871	819	88	79	L
Nevada	283	302	N/A	N/A	N/A	N/A	H
Oregon	N/A	N/A	2,097	1,990	148	145	H
Washington*	2,936	3,208	N/A	N/A	1,053	1,209	T
TOTAL	$98,406	$95,596	$104,516	$100,559	$24,415	$22,629	

L = revenues lower than estimates; H = revenues higher than estimates; and T = revenues on target.

NOTES TO TABLE A-6

Connecticut	Personal income tax includes capital gains, dividends, and interest tax only.
Georgia	Current sales tax estimate includes $116 million not in original estimate. A limited food exemption was halted by a court challenge.
Kansas	Current personal income tax estimate is the consensus revenue estimate adjusted by the Governor's recommendation.
Michigan	The Single Business Tax is reported under corporate income tax.
New York	Current sales tax estimate does not reflect anticipated change in payment schedule.
Rhode Island	Current estimates exclude tax increases passed on February 14, 1991 that amount to $28 million for the sales tax, $3 million for the personal income tax, and $5 million for the corporate income tax.
Texas	The sales tax rate was increased from 6 percent to 6.25 percent effective July 1990 during a special legislative session.
Washington	Figures reported under corporate income tax are for the corporate business and occupations tax.

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Table A-7
PROPOSED 1992 REVENUE CHANGES BY TYPE OF REVENUE

State	Tax Change Description	Effective Date(s)	Fiscal 1992 Revenue Change ($ in millions)
SALES TAX			
Arkansas	Increase from 4.0 percent to 4.5 percent.	5/91	$121.9
	Apply tax to used cars ($2,000 floor).	5/91	48.1
California	Eliminate certain exemptions.	4/91	283.0
Connecticut	Reduce rate from 8 percent to 4.25 percent and expand base to include clothing under $75 in value, children's clothing, gasoline, movies and amusements, magazines and newspapers, and other items.	7/91	-933.1
Florida	Close loopholes and institute administrative adjustments.	7/91	55.9
Kansas	Broaden tax base to include certain services.	7/91	478.4
Maine	Freeze manufacturers fuel tax rate at 2 percent	7/91	10 0
Minnesota	Realize increase due to cigarette tax increase.	7/91	3 0
New York	Expand base to include interstate and international telecommunications, certain moving services, non-custom computer software, the "shipping" portion of shipping and handling, telephone answering services provided by individuals, mandatory gratuities, and certain food sold to airlines	9/91	69.0
Ohio	Eliminate early payment discount.	7/91	53.4
	Cap receipts going to local governments	12/91	7.9
Pennsylvania	Include cable TV and interstate phone use; include liquor at retail rather than wholesale	7/91	288 0
Tennessee	Exempt food	1/92	N/A
	Reduce combined state and local rate from 8 25 percent to 6 percent.	7/92	N/A
Vermont	Increase rate from 4 percent to 5 percent and broaden base to include soda, beer, wine, and snack foods. Provision expires December 31, 1993.	3/91	38.1
Wisconsin	Redefine taxable telecommunications services and materials removed from state.	7/91	3.5
PERSONAL INCOME TAX			
Arkansas	Remove low-income households from tax rolls.	1/91	-$14 2
California	Change in certain withholding (generally one-time revenues).	1/91	370.0
Connecticut	Institute tax of 6 percent of federal adjusted gross income with a $12,500 exemption for single filers and a $25,000 exemption for joint filers.	7/91	2,360.0
	Eliminate separate tax on capital gains, dividends, and interest, and incorporate these items into the new personal income tax.	7/91	-526.0
Illinois	Make surcharge permanent. No revenue increase.		

Table A-7 (continued)
PROPOSED 1992 REVENUE CHANGES BY TYPE OF REVENUE

State	*Tax Change Description*	*Effective Date(s)*	*Fiscal 1992 Revenue Change ($ in millions)*
Kansas	Acceleration of payment dates for one-time gain in fiscal 1991.	5/91	8.0(FY91)
Maine	Revise alternative minimum tax.	1/91	3.4
	Accelerate withholding payments for large employers.	5/91	0.6
	Delay investment tax credit.	7/91	2.0
Minnesota	Conform to federal internal revenue code.	1/91	36.0
Montana	Subject retirement income to tax.	7/91	9.9
New York	Extend freeze of tax rate cut scheduled for 1990 and continue 1989 rates. No revenue increase.		
Ohio	Change employer withholding schedule.	7/91	10.0
	Cap receipts going to local governments.	12/91	21.2
Oregon	Repeal "2 percent kicker" law and reconnect to the federal income tax code.	7/91	70.0
Rhode Island	Increase rate from 22.96 percent of federal liability to 27.5 percent of federal liability.	3/91	102.0
Tennessee	Introduce a 4 percent tax and repeal existing tax on investments.	1/92	N/A
Vermont	Increase tax rate by one percentage point and extend 3 percentage point surcharge; 4 percentage point increase for taxpayers with federal liability exceeding $16,000. Provision expires December 31, 1993.	1/91	37.4
CORPORATE TAXES			
Connecticut	Eliminate 20 percent surcharge so that effective rate drops from 13.8 percent to 11.5 percent.	1/92	-$55.0
Maine	Revise alternative minimum tax.	1/91	2.1
	Delay investment tax credit.	7/91	18.1
	Delay biomass investment tax credit.	1/91	1.5
Michigan	Replace Capital Acquisition Deduction (CAD), which was ruled unconstitutional, with an investment tax credit. The policy is revenue neutral but timing differences result in gain.	3/91	50.0
Minnesota	Conform to federal internal revenue code.	1/91	3.0
New York	Eliminate tax expenditure that allows certain corporations to allocate income to states that cannot tax that income.	1/91	25.0
Ohio	Cap receipts going to local governments.	12/91	1.7
Oregon	Reconnect to the federal income tax base and eliminate pollution control facility credit.	7/91	11.0
Pennsylvania	Rate increase of 2 percent, federal treatment of dividends.	1/91	334.0
Rhode Island	Impose 11 percent surcharge until January 1, 1993.	3/91	5.0
Wisconsin	Remove pari-mutuel and "carline" exemption.	7/91	2.2
	Conform to federal tax code.	7/91	0.7

Table A-7 (continued)
PROPOSED 1992 REVENUE CHANGES BY TYPE OF REVENUE

State	*Tax Change Description*	*Effective Date(s)*	*Fiscal 1992 Revenue Change ($ in millions)*
CIGARETTE AND TOBACCO TAXES			
Iowa	Increase of 10 cents/pack.	3/91	$25.6
Minnesota	Increase of 24 cents/pack.	7/91	77.0
Nevada	Eliminate sunset on 1989 increase.	7/91	20.7
Ohio	Eliminate stamp discounts to dealers.	7/91	3.8
Oregon	Dedicate $20 million in cigarette tax revenues to the Westside light rail project. Loss to general fund.	7/91	-10.4
Pennsylvania	Increase of 30 cents/pack.	7/91	300.0
Vermont	Increase of 4 cents/pack.	3/91	2.7
MOTOR FUEL TAXES			
Connecticut	Increase of 2 cents/gallon dedicated to local government infrastructure projects.	7/91	$30.5
Idaho	Increase of 6 cents/gallon (with half dedicated to local governments)	4/91	35 0
New Hampshire	Increase of 2 cents/gallon.	7/91	5 0
New York	Increase of 10 cents/gallon to fund a dedicated highway fund.	5/91	500.0
Rhode Island	Increase of 5 cents/gallon	4/91	20.4
ALCOHOLIC BEVERAGES			
California	Increase tax rate.	7/91	$17.0
Iowa	Tax beer as liquor.	3/91	2.4
Minnesota	Increase beer and wine taxes to levels more comparable to liquor tax.	7/91	11.0
North Carolina	Increase beer tax and licenses	7/91	4 6
MISCELLANEOUS TAXES			
California	Change depreciation schedule for vehicle registration fees.	N/A	$12 0
	Rate increase for driver's license and vehicle registration fees.	N/A	73.0
Florida	Increase user fees.	7/91	226.2
	Increase educational tuition.	7/91	96.5
	Increase license plate renewal fees.	7/91	10.2
Idaho	Double vehicle registration fees and truck trip permits (with half dedicated to local governments).	7/91	29.0
Kansas	Acceleration of liquor, privilege, and mineral taxes for one-time gain in fiscal 1991.	5/91	13 8(FY91)
Maine	Increase audit staff.	7/91	4.0
	Modify property tax and rent refund program.	8/91	9.4
	Delay homestead property tax exemption.	4/91	12.9
Michigan	Various fee increases.	N/A	31.0
	Contributions from hospitals providing Medicaid services.	N/A	70.0
Montana	Introduce oil and gas incentives.	7/91	-4 2

Table A-7 (continued)
PROPOSED 1992 REVENUE CHANGES BY TYPE OF REVENUE

State	*Tax Change Description*	*Effective Date(s)*	*Fiscal 1992 Revenue Change ($ in millions)*
Nevada	Impose business activity tax and business license fee.	7/91	129.5
	Change basis of scot route operators gaming assessment fee.	7/91	7.0
New York	Convert weight-based vehicle registrations to an ad valorem basis and increase motor vehicle fees that will be offset by other changes in this category.	9/91	12.0
	Eliminate certain tax expenditures under bank tax.	1/91	10.0
	Revise estate tax rates and credits.	enactment	40.0
	Impose $5 tax on tires to help finance Environmental Infrastructure Fund.	enactment	50.0
	Enact administrative and technical changes to reform withholding, reverse court decisions, etc.	enactment	77.0
Oregon	Redefine the tax base for the amusement device tax.	7/91	0.4

Table A-8
PROPOSED STATE EMPLOYMENT COMPENSATION CHANGES, FISCAL 1992

State and Region	*Across the Board*	*Merit*	*Other*	*Notes*
New England				
Connecticut	*	—	—	Although half of the collective bargaining units have settled contracts for fiscal 1992, the Governor's recommended budget was reduced by $417 million to reflect anticipated savings from collective bargaining negotiations with employee unions. The negotiations, which are taking place at this time, include wages.
Maine	7.0%	2.0%	—	An additional 5 percent for confidential and supervisory unit is effective 10/1/91. Compensation package for fiscal 1992 was ratified by state and union but was not funded.
Massachusetts	—	—	—	Employee compensation package is still under discussion.
New Hampshire	—	—	—	Employee compensation package is still under discussion.
Rhode Island	—	—	—	No increases are recommended.
Vermont	3.25	—	—	In addition, all eligible employees receive step increases.
Mideast				
Delaware	—	—	—	No increases are recommended.
Maryland	—	—	—	No increases are recommended.
New Jersey	5.5%	3.0%	—	Merit increases range from 3.5 percent to 5.0 percent, depending on employee step and range, except at maximum of range no merit increase is given. Estimated cost is 3.0 percent on average. Although the contract is agreed to, because of fiscal situation this contract is not funded in fiscal 1992.
New York	—	—	—	Compensation package has not been negotiated yet.
Pennsylvania	—	—	—	Compensation package has not been negotiated yet.
Great Lakes				
Illinois	—	—	—	Compensation package has not been negotiated yet and Governor's budget assumes no pay increase as well as contract take-backs.
Indiana	—	—	—	No increase is recommended.
Michigan	4.0%	—	—	Governor's 1992 budget recommends rejecting pay raise.
Ohio	4.0	—	—	Collective bargaining contracts for 1991 and 1992 will be renegotiated.
Wisconsin	—	—	—	Compensation package has not yet been negotiated.

Table A-8 (continued)
PROPOSED STATE EMPLOYMENT COMPENSATION CHANGES, FISCAL 1992

State and Region	*Across the Board*	*Merit*	*Other*	*Notes*
Plains				
Iowa	—	—	—	Increases are not yet determined.
Kansas	1.5%	—	2.5%	ATB is for the last half of fiscal 1992. Other is based on movement from step to step on the classified pay matrix.
Minnesota	—	—	—	No specific package has been recommended, nor has separate funding been set aside for labor contracts currently under negotiation. Any increases will be funded within existing budget levels.
Missouri	—	—	—	No increase is recommended
Nebraska	3.0	—	*	All employees receive 3.0 percent on July 1, an additional 1.5 percent on anniversary date, and an additional 1.0 percent if employed 10 years with the state and below the midpoint of salary range (subject to satisfactory performance).
North Dakota	4.0	—	—	The package includes 4.0 percent or $50 per month, whichever is greater
South Dakota	4 0	—	*	The Governor has recommended longevity increases based on all years of service, adjustments for certain pay grades that range from 0 3 percent to 8 9 percent, and an adjustment of 2 5 percent for employees below the midpoint of their pay range
Southeast				
Alabama	*	5%	*	ATB recommendations have not yet been made. Merit raises based on employee performance and may range from 0-5 percent based on evaluation Longevity pay ranges from $300-$600 per employee per year based on years of service.
Arkansas	2 5	2.5	—	Employees are eligible for a 2 5 percent merit increase on their anniversary date
Florida	3.0	—	—	Nurses are to receive an average increase of 15 percent of minimum pay, child welfare classes are to receive 12.5 percent; judiciary law enforcement investigators are to receive $3,000.
Georgia	—	—	—	Although there is no policy against in-step salary increases, restrictions on agency budgets will limit their availability.
Kentucky	5 0	1.5	2 0	There is an appropriation of $13.5 million to address market, recruitment, and retention needs in state government.
Louisiana	—	3.6	—	Approximately 10 percent of the workforce is at the top of its pay grade and not eligible for a merit increase. Therefore, a 4 percent increases averages 3 6 percent
Mississippi	—	—	—	No increase is recommended.
North Carolina	—	2.0	—	A 2 percent performance pay increase is effective January 1992.

Table A-8 (continued)
PROPOSED STATE EMPLOYMENT COMPENSATION CHANGES, FISCAL 1992

State and Region	*Across the Board*	*Merit*	*Other*	*Notes*
South Carolina	—	—	—	All proposed increases are to "annualize" increases implemented in fiscal 1991 for a portion of the year.
Tennessee	4.0	—	—	Funding is subject to economic recovery.
Virginia	—	—	—	No increase is recommended.
West Virginia	—	—	—	No increase is recommended.
Southwest				
Arizona	—	—	—	No increases are recommended.
New Mexico	•	—	5.0%	Employees would receive enhanced benefits and take home increase totalling 3 percent across the board
Oklahoma	—	2 4	—	Governor has proposed a performance pay package that would average 2 4 percent if given to all employees. Since it is targeted to certain employees, the individual increases will be larger.
Texas	—	—	—	In the past few years, employee pay increases have been added to the budget during the last days of the legislative session
Rocky Mountain				
Colorado	3 3%	1 3%	—	Correctional officers classification is under study but there is no planned increase.
Idaho	—	5 0	0 3	"Other" is to move employees with 5 or more years in the same position with satisfactory performance toward the mid-point of the salary schedule
Montana	3 0	—	1 5	"Other" is an average "progression increase" to move salaries closer to market level In addition, state is increasing the insurance contribution by $180 per year.
Utah	—	3 0	2 0	"Other" is to cover benefit cost increases
Wyoming	—	2 5	3 8	Most employees will receive a merit increase after an increase in health insurance contribution of $50 per month for employees earning less than $20,000 per year and $40 per month for those earning more than $20,000. State contribution to retirement system will increase from 66 percent to 90 percent
Far West				
Alaska	5.0%	3.0%	—	
California	—	•	—	Merit salary adjustments are provided within departments and range from 0-5 percent Costs for these increases are absorbed within existing budgeted resources
Hawaii	4 0-5 0	—	—	
Nevada	4 0	2 5	—	Annual merit increase of 5 0 percent is available to those qualifying and not at top of pay grade. Fiscal year equivalency is 2.5 percent.

Table A-8 (continued)
PROPOSED STATE EMPLOYMENT COMPENSATION CHANGES,
FISCAL 1992

State and Region	*Across the Board*	*Merit*	*Other*	*Notes*
Oregon	—	•	—	Almost all employees receive a merit increase unless they are at the top of their salary range. Very few are at the top because state just implemented a new classification syster· nd most employees' salary ranges increa· .
Washington	4.6	—	0 6	About 26,000 of 60,000 classified er pi·, es will receive increases for "comp · ·ole worth." In additional, about 45 percent of all classified employees will receive an annual step increase of 5.0 percent.

Table A-9

BUDGET REDUCTION STRATEGIES IMPLEMENTED OR UNDER CONSIDERATION, FISCAL 1991

State	*A-T-B Cuts*	*Targeted Cuts*	*Lay-offs*	*Fur-loughs*	*Taxes*	*Other Revenues*	*Delay Spending*	*Borrow/ Bond*	*Rainy Day Fund*	*Reduce/Delay Pension Fndng*	*Hiring Freeze*	*Travel Freeze*
Alabama	I								I			
Alaska												
Arizona		I									I	I
Arkansas												
California	I				I	I	I		I		I	
Colorado							I					
Connecticut		I	X					X			I	I
Delaware		I					I				P	
Florida		I							I			
Georgia	I	I							I	I	I	I
Hawaii												
Idaho												
Illinois		I										
Indiana		I									I	P
Iowa		I			I		I				I	I
Kansas												
Kentucky												
Louisiana												
Maine	X	X	X	X		X				X	X	X
Maryland		I				I			I		I	I
Massachusetts	I	I	I	I		I	I			I	I	I
Michigan	I	I,X	I				I		X		I	
Minnesota		I				I				I	I	I
Mississippi	I	I							I		I	I
Missouri	I	I				I	I				I	I
Montana												
Nebraska												
Nevada												
New Hampshire	X	X	X	X								
New Jersey	I	I	I				I				I	I
New Mexico												
New York		I	I			I	I	I		I	I	I
North Carolina	I						I		I	I	I	I
North Dakota												
Ohio	I	I	I			I			I	I	I	I
Oklahoma												
Oregon												
Pennsylvania	I	I		I	X	X	I		I	X	I	I
Rhode Island		I	I	I	I	I	I		I	I	I	I
South Carolina		I							I			
South Dakota												
Tennessee	I					I	I		I		I	I
Texas												
Utah												
Vermont	I	I	I	I	I				I		I	P
Virginia	I	I	I	I						I		
Washington												
West Virginia												
Wisconsin												
Wyoming												
Total	16	24	11	7	5	11	13	2	14	10	22	19

Key: X = Strategy proposed I = Strategy implemented P = Strategy partly implemented

PREPARED STATEMENT OF SENATOR DOMENICI

Mr. Chairman, distinguished Members, it is with great pleasure that I come before this Committee to testify in strong support of legislation I have been pursuing for several years—S. 90—the Environmental Infrastructure Act of 1991.

I cannot think of a more appropriate time for this Committee to be reviewing S. 90. On the Senate floor right now, we are considering a major new bill to provide important funding for our nation's highways and transportation programs. This bill moves us forward over the next five years to tackle the significant backlog of maintenance on our nation's highways and to address the transportation needs of our growing cities. [IF SENATORS MOYNIHAN CHAFEE AND SYMMS ARE PRESENT—COMMEND THEM ON THIS BILL]

But what about other infrastructure problems—our deteriorating water and sewer system; our landfills that have reached capacity?

S. 90, Mr. Chairman, is a step in the right direction in our effort to help communities with these and other environmental projects?

Over the past 20 years, the Congress has passed a multitude of environmental laws. Much of the burden of meeting the environmental standards set in these laws rests with our states and our municipalities. However, what the Congress has not done, is adequately attempt to grapple with the question of financing these extremely important project. We have a are opportunity to begin to come to terms with that problem.

The Environment and Public Works Committee will be reauthorizing both the Clean Water Act and the Resource Conservation Recovery Act (RCRA) during this next Congress. Many of the Members who serve here on the Finance Committee also serve on the Public Works Committee. I cannot think of a better time for the two Committees to work together to determine how our municipalities will meet present environmental requirements and new ones that will emerge during reauthorization of these two statutes.

OUR ENVIRONMENTAL INFRASTRUCTURE

But first, let me discuss what I like to term America's "environmental infrastructure." In doing so, I want to quote from a study that was done several years ago on America's infrastructure.

"If we spend too little on public works or if we invest in inefficient projects, society loses more than the direct public cost. In the long run, our ability to compete in the international economy will be weakened, and our standard of living will suffer.

That is a sound assessment. There is no doubt that, over the long run, a close link exists between our infrastructure and our competitive position in the world, our productivity.

Nor is there any doubt that we—throughout the entire political system—have allowed much of our national infrastructure to decline over the past three decades.

Infrastructure spending is down across the nation. It was 2.3 percent of our GNP in 1960; it is about 1 percent today.

The Congress confronts many alternatives. Some people tell us that we can solve our infrastructure problems by taking all the existing infrastructure trust funds off budget.

Others may say we need to move toward a capital budget at the Federal level, or a major infusion of new Federal grants. Some argue for higher, dedicated taxes.

Each of these alternatives merits attention. We need to encourage the construction of environmentally-related investments in every way we can. Our assistance is needed, not only because of the value of the investment, but because the Federal government has mandated these investments.

But let me focus my remarks on S. 90, that Senator Boren and I have sponsored.

Our bill is a relatively narrow one, designed to benefit four basic types of public works, each related to improving the American environment:

- *Water supplies;*
- *Sewage treatment;*
- *Solid and hazardous waste disposal; and*
- *Facilities needed to meet EPA standards.* This final category would include such things as mass transit investments in those regions of the nation where air pollution problems exist.

What S. 90 does is to encourage the construction of such facilities through the bond market. Frankly, I can't see how we can meet future needs without greater reliance on the bond market.

The Domenici-Boren bill will make these public works improvements less costly as investments, both to local government and the private sector, by ensuring that these investments receive fair and favorable treatment in the Tax Code.

I do not need to tell this Committee that the ease with which local governments finance public facilities through bonds is governed directly by the Tax Code. In turn, local utility rates are determined by how local capital investments are financed.

Large sums are at stake. The Public Securities Association found that over the period from 1984 through 1988, state and local jurisdictions issued an average of $137.2 billion annually in municipal bonds for public purposes.

Assuming that average annual interest rates remain constant, the PSA concluded that if those five years of bonds had all been taxable, the added burden by the end of this century on communities and states would have been $283 billion.

To help build our future, S. 90 creates a new category of tax-exempt bond, an "*infrastructure bond.*" An infrastructure bond would be an obligation, issued by a state or local government, that is used to finance any of the four types of public facilities I have cited.

These public infrastructure bonds would be freed from constraints imposed on tax-exempt bonds in recent tax laws. These bonds would not be subject to a cap. These bonds would not be subject to the alternative minimum tax. These bonds could be refunded at any time.

S. 90, I should point out, is based directly upon the recommendations of two important recent studies of America's infrastructure.

The initial study came from a distinguished panel of public officials and private citizens, the *Private Advisory Panel on Infrastructure Financing.* That Panel was established several years ago to advise the Senate Budget Committee on techniques the Congress might use to increase public investments in roads, dams, airports, bridges, water systems, and waste disposal.

The second report—"Fragile Foundations: A Report on America's Public Works"—was released two years ago by an equally distinguished group, the *National Council on Public Works Improvement.*

Both reports concluded that America faces a great challenge in reviving our decaying public works investment. Both reports deserve your careful attention.

Since then, the Congressional Budget Office's study, "New Directions for the Nation's Public Works," suggested greater non-Federal responsibility in targetting infrastructure investments.

Infrastructure bonds are one area of concern to me. Another is public-private partnerships, which have taken on new importance as we seek capital to meet public needs.

So the second major thrust of S. 90 encourages private investments in public facilities. S. 90 extends to all types of environmental infrastructure facilities the same tax treatment the Tax Code now gives only to solid waste facilities.

To attract private investment, sewage, solid and hazardous waste, and water facilities must hold the promise of profitability. Projects of this sort are long-term investments. They do not generate a quick profit; the return is low and spread over many years. The cost-recovery rules now in the Tax Code lessen the economic feasibility of such arrangements.

I think the National Council may have set the correct tone when it said America needed "a national commitment shared by all levels of government and the private sector, to increase capital spending by as much as 100 percent above current levels."

The Joint Committee on Taxation has examined the version of S. 90 that we introduced during the 100th Congress; it estimated the cost in lost revenues at about $350 million per year. This is certainly a modest revenue loss in comparison with the benefits and need.

Mr. Chairman, the Environmental Infrastructure Act of 1991 is but one step forward in a comprehensive program to meet America's infrastructure needs. Support for the bill continues to grow. A number of important organizations endorsed this bill under its earlier number, S. 700—organizations such as the American Consulting Engineers Council and the National Association of Home Builders.

Mr. Chairman, I look forward to working with you and the Committee on this extremely pressing problem. I would be happy to answer any questions at this point.

Prepared Statement of Harley T. Duncan

Mr. Chairman and Members of the Committee: The Federation of Tax Administrators extends its appreciation for this opportunity to appear before you on S. 267, a bill which would prohibit states and political subdivisions from imposing an income tax on the pension or retirement income of a person who is not a resident or domiciliary of the state or political subdivision. The Federation and its members oppose this measure and respectfully request that you not enact it.

INTRODUCTION

The Federation of Tax Administrators (FTA) is a non profit corporation comprised of the principal tax and revenue collecting agencies in each of the fifty states, the District of Columbia, New York City and the Provinces of Ontario and Quebec, Canada. Our purpose is to improve the techniques and standards of tax administration through a program of research, information exchange, training, and representing the interests of state tax administrators before the Congress and federal executive branch. The Federation is governed by a 15 member Board of Trustees elected by the 54 member agencies.

The policy of the Federation with respect to this issue was embodied in Resolution Sixteen adopted unanimously by the membership at its June 1990 Annual Meeting in Charleston, S.C. A copy of the resolution is attached.

The Federation opposes enactment of S. 267 (and similar measures) because it runs directly counter to the fundamental underlying principle of state income taxation—namely that income should be taxed where it is earned or the "source principle." As such, enactment of S. 267 would overturn a long history of judicial precedent and strike at the heart of state sovereignty—the ability to define the state's own tax system within the confines of the U.S. Constitution. Other reasons states oppose enactment of S. 267 include: (a) It would create serious inequities with other similarly situated taxpayers; (b) This is an issue of state tax policy which is best left to resolution by state legislatures; (c) S. 267 could lead to enactment of other, less desirable, alternatives; (d) The premises underlying the bill are erroneous; and (e) The legal basis for the legislation is less than clear. The remainder of this testimony addresses each of these concerns; it also presents results of a survey of states on the taxation of nonresident pension income.

SOURCE TAX PRINCIPLE

The basis of current state income tax systems is that a state may tax income that is derived from "sources" within the state. In-state sources are defined generally to include the performance of services in the state, the conduct of a trade, business or occupation in the state, or the receipt of income from property owned within the state. Further, income from in-state sources are subject to tax regardless of whether it is earned by a resident or a nonresident who otherwise enters the state for a period of time to carry on the income-producing activity.

Authority to Tax. State authority to tax nonresident income from in-state sources was validated by the U.S. Supreme Court over 70 years ago in *Shaffer* v. *Carter* 252 U.S. 37(1920) when it wrote:

> . . . we deem it clear, upon principle as well as authority, that just as a State may impose general income taxes upon its own citizens and residents . . . , it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to non-residents from their property or business within the state, or their occupations carried on therein . . . .

As the *Shaffer* court noted, and as has been developed in subsequent cases, the essential constraint on the states in the taxation of nonresident income is that the nonresident not be taxed to a greater degree than a similarly situated resident of the state and may not be discriminated against by virtue of the nonresident status. Beyond this, the Court has essentially left it to state legislatures to control nonresident taxation.

Authority to Tax Pension Income. With respect to nonresident pension or retirement income[1] in particular, states take the position that the pension income is simply deferred income or compensation for services performed at an earlier point in time. Thus, a state has authority to tax that portion of the retirement income of a nonresident that results from services performed earlier in the taxing state. The issue of taxing nonresident pension income has not been addressed directly by the Supreme Court. The Court's ruling in *Davis* v. *Michigan Department of Treasury* 109 S.Ct. 1500 (1989) (intergovernmental tax immunity and 4 U.S.C. 111 prevent a state from taxing federal pensions to a greater degree than they do state and local pensions), however, certainly supports the state interpretation that pensions are deferred income paid for services performed previously. In Davis, the Court clearly stated that the deferred nature of federal pension income did nothing to disrupt its character as "federal compensation" which was subject to the limits on differential taxation contained in 4. U.S.C. 111 and the constitutional doctrine of intergovernmental immunity.

Double Taxation. In addition to the taxation of nonresident income, it is also clear that states have authority to tax all income received by a resident, regardless of the source of that income.[2] Thus, one could hypothesize a case of potential 'double taxation' where the retirement income would be taxed in the state where the services were performed and in the state of residence of the retiree. This does not happen in practice, however, and *concern for double taxation cannot be the basis for supporting enactment of S. 267.* All states with a broad-based income tax[3] provide a tax credit to residents for income taxes paid to another state on income which is also included in the tax base of the state of residence.[4] This system of reciprocal credits prevents retirement (and other) income from being taxed in both the state in which it is earned and in the state of residence.[5]

Policy Significance. Thus, it seems clear that states choosing to impose tax on nonresident pension income are well within the constitutional latitude granted them as sovereign entities. They are taxing income from "sources" within the state. Moreover, they are not discriminating against nonresidents by taxing them at higher rates than residents, and they have taken steps to avoid any double taxation (and consequent Due Process concerns) through a system of reciprocal credits for taxes paid to another state.

The "source tax" principle is important to the states and is important to our federal system. Within their sphere of responsibility, states are able to define the level of government services they desire. Further, they are, within the bounds of the U.S. Constitution, free to tax the activities occurring within the state to finance those services. The source tax principle is consistent with and necessary to that federal system. Abrogation or abandonment of the source tax principle would create a situation in which persons could avail themselves of the marketplace created by one state and many of the services provided by that state without compensation to the state. It could well lead to a series of "tax havens" in certain interstate metropolitan areas and unhealthy interstate tax competition which would have the ultimate effect of weakening all parties concerned. The source tax principle should not be lightly discarded by the U.S. Congress.

STATE PRACTICES

To clarify some confusion over the extent to which states attempt to impose tax on nonresident pension income, the Federation of Tax Administrators, in May 1991,

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[1] Throughout the testimony, references to nonresident pension or retirement income should he read to refer to that portion of any deferred compensation arrangement which is attributable to services performed in the state at a earlier point in time. A state would not have authority to tax pension income of a nonresident if it did not arise from services or other activities performed in the state.

[2] *New York ex. rel. Cohn* v. *Graves,* 300 U.S. 308 (1937) and *Lawrence* v. *State Tax Commission*< 286 U.S. 276 (1932).

[3] Forty states and the District of Columbia levy a broad-based personal income tax. Connecticut, New Hampshire and Tennessee levy an income tax on limited types of interest, dividend and capital gains income. Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not levy a personal income tax.

[4] Maine and Virginia do not grant such a credit on retirement income. Neither state, however, includes retirement income from non-state sources in the tax base of the resident.

[5] Certain groups of states do not use such a system of credits. Instead, they have reciprocal agreements under which all income is taxed by the state of residence rather than the state in which it is earned. (This also avoids taxation by two states.) These agreements are most prevalent in the Virginia-D.C.-Maryland, Pennsylvania.New Jersey, and Ohio-Indiana-Illinois areas.

surveyed state tax agencies with respect to their practices in taxing nonresident pension income. That survey yielded the following results.[6]

Thirteen states responded that their income tax statute would authorize imposition of tax on nonresident pension income: Arizona, California, Georgia, Iowa, Kansas, Kentucky, Louisiana, Minnesota, New York, North Dakota, Ohio, Oregon and Vermont. Five of these states (Arizona, Georgia, Kentucky, Louisiana and North Dakota), however, answered that they do not attempt to impose the tax on nonresident pension income. Of the remaining eight states, only California, New York and Vermont report that they have a program in place to attempt to identify nonresident pension income recipients.

Some states taxing nonresident pensions have important limits on the types and amount of pension income subject to tax. Ohio and Vermont impose tax only on distributions to nonresidents from "non-qualified" deferred compensation arrangements. Similarly, New York exempts the first $20,000 in retirement income for both residents and nonresidents and does not tax annuities received by nonresidents from New York sources. Some of the other states also exempt a portion of the pension income of certain types of resident and nonresident retirees (e.g., state, local and federal employees.)

In short, eight states respond affirmatively to the taxation of nonresident pension income. In New York, Ohio and Vermont, the coverage is limited to a relatively narrow category of retirement income.

OTHER ISSUES

Tax Inequities. Enactment of S. 267 or other similar measures, rather than correcting some perceived inequity, would create inequities in the tax burden of similarly situated taxpayers.

It would have the effect of converting what was intended to be a tax deferral designed to promote retirement savings and self-sufficiency into a tax exemption for those retirees who had the ability and desire to move to a state with no income tax. In the interests of simplicity and retirement policy, most states have conformed their income taxes to the federal tax, thus allowing tax to be deferred on certain contributions to retirements systems and deferred compensation arrangements. At the federal level, and intended at the state level, these contributions would be taxed on withdrawal when the income is actually available to the recipient. Enactment of S. 267 would, however, convert this deferral to an exemption for those retirees who choose to move to a state without an income tax.[7]

The attempt to avoid tax entirely, rather than any philosophical concern, seems to be crux of the issue with respect to taxing nonresident pension income. As an American Association of Retired Persons (AARP) policy paper noted, "Because the [nonresident pension] income has not previously been taxed, there seems to be no compelling case against this tax on fairness grounds . . . ."[8] That same publication outlined the essential characteristic of this debate when it said:

> In general, this issue would probably have little salience, even if more states engaged in the practice, if retirees only moved between states which levy broad-based income taxes. In these cases, the tax would be levied by both the state of residence as well as the source income state. However, double taxation would normally be avoided by virtue of credits allowed by the state of residence for nonresident taxes paid. . . . It is usually when an individual moves to one of these states [with no income tax] from one of the handful of states levying a tax on nonresident pensions that the issue becomes salient.[9] (citations omitted.)

S. 267 would create inequities between persons who move from a state and a person who remains in the state. Despite the fact that both persons may have spent all their working years in the state, the one who remains a resident will face a higher lifetime tax than the one who moves. As Smith and Hellerstein noted in a recent analysis of the interstate issues involved in taxing federally deferred income, " . . . it nevertheless offends our notions of fairness to provide the person who moves interstate with a tax windfall not available to one who moves intrastate."[10]

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[6] Complete survey results are available from the Federation of Tax Administrators on request.

[7] Retirees moving to a state with an income tax would be taxable in either the state in which they reside or in the state where the services were performed, but not both.

[8] John R. Gist and Mark Schorsch, "State Taxation of Non-Resident Pension Income," American Association of Retired Persons Public Policy Institute, No. 9001, February 1990, p. 6.

[9] Gist and Schorsch, *op. cit.*, p. 3.

[10] James Charles Smith and Walter Hellerstein, "State Taxation of Federally Deferred Income: The Interstate Dimension," *Tax Law Review*, Vol. 44, p. 351.

State Legislative Role. Under current law, the decision to tax nonresident pension income is clearly a matter of state tax policy to be determined by the State Legislature. It should remain this way. Determining whether and in what manner to tax nonresident pension income is an issue that must be decided within the context of state tax policy generally. The decision must consider matters such as the degree to which the state taxes other retirement income, the economic and demographic characteristics of the state, the tax policy of surrounding states, administration, and the treatment of other nonresident income. The balancing of these interests cannot be accomplished through a blanket policy adopted by the Congress; it must be accomplished at the state level.

The varying state practices are evidence that state legislatures take these factors into account and arrive at different answers. Most states have, in fact, determined not to tax nonresident pensions. Others such as Ohio, Vermont and New York tax only a limited portion of nonresident pension income. Laws in these states are designed primarily to avoid situations in which a wealthy person could choose to defer large amounts of current income in anticipating of retiring and moving to a non-income tax state where the deferred amounts could be withdrawn tax free. In addition, the California legislature in 1990 considered a measure which would have exempted up to $20,000 in nonresident pension income, thus avoiding tax on low-income nonresident retirees.[11] A blanket prohibition such as embodied in S. 267 would not respect these judgments. It would instead simply prohibit all taxation.

Some may argue that there are no effective constraints on state legislatures in their consideration of nonresident issues. This is simply not the case. As noted above, the Constitution requires that state taxes on nonresident income may not be more onerous in their effect" on nonresidents than they are on residents. In addition, the action of any one state is constrained by the actions of others. That is, if one state is considered especially onerous in its tax policy, its residents (particularly retirees) may simply to choose to move elsewhere.[12]

Undesirable Alternatives. It is no secret that with the recession and growing medical, education, corrections and other service needs, states are hard pressed to generate the revenues necessary to meet the demands placed on them. If S. 267 or similar measures are enacted, it is reasonable that they would examine other means of taxing amounts deferred under federal law when they are prohibited from taxing a portion of them on withdrawal. It is very likely that any of these alternatives would have undesirable side effects.

For example, states might consider alternatives such as not recognizing certain federal deferral techniques, taxing certain deferred income on a current basis, or otherwise limiting amounts which could be contributed to deferred arrangements. Each alternative would overcome the effect of S. 267. Each would, however, also create areas of non-conformity with the federal tax, increase the complexity of state and federal taxes for taxpayers and employers, and frustrate stated U.S. retirement policy. Nonetheless, if prohibited from taxing nonresident pensions on withdrawal, states would necessarily be forced to consider such alternatives.

Faulty Premises. Supporters of S. 267 and similar measures argue that taxing nonresident pensions somehow constitutes "Taxation Without Representation." The concern is that without some "representation," states will simply raise "nonresident tax rates" whenever they need money.[13] Such statements are patently untrue. As noted earlier, the U.S. Constitution clearly provides that nonresidents may not be taxed in a manner which causes the effect of the tax to be greater than for similarly situated residents. No action could be taken which would raise "nonresident rates" to levels greater than those of residents. In addition, the Supreme Court over 70 years ago ruled that states could constitutionally tax nonresident income.[14] An indi-

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[11] This measure would have effectively exempted over 95 percent of California Public Employee Retirement System employees giving in non-income tax states, but was opposed by RESIST (an organization of retired California employees living primarily in Nevada.) (Source: "Issues Surrounding Federal Bills To Prohibit State Taxes on Non-resident Pension Income," Prepared for the Board of Administration, California Public Employees' Retirement System by David Vienna and Associates, Alexandria, Va., April 5, 1991.

[12] See Gist and Schorsch, *op. cit.*, p. 7.

[13] See, for example, "Arguments in Support of AB-3976," by William (Bill) C. Hoffman, President, RESIST of America as reprinted in Vienna and Associates, *op. cit.* AB 3976 was a bill considered by the 1990 California Legislature. It would have exempted nonresident retirement income. RESIST is the acronym for "Retirees to Eliminate State Income Source Tax."

[14] *Shaffer* v. *Carter*, 252 U.S. 37 (1920).

vidual earning income within a state has clearly brought himself within the jurisdiction of the state and availed himself of state services. For that, a tax on the income (whether received currently or on a deferred basis) may lawfully be asked. As the AARP policy paper noted, "As long as nonresidents and residents are treated equally, and income is not taxed twice, this argument [taxation without representation] represents only an appealing political argument and not a cause of legal action." [15]

Opponents of nonresident pension income taxation also argue that the pension recipient receives no services from the state, and thus should not be subject to tax. The fact remains that this is not a new tax; it is taxation of deferred income arising from services performed at an earlier point in time. Moreover, the income was deferred for the benefit of the taxpayer who used state services at the time the income was earned. While services and payment may not coincide in time, both are accounted for at some point, and the taxpayer benefits from a savings that is allowed to grow tax-free. The states are simply not overreaching the constitutional bounds of their state tax sovereignty.

Finally, opponents of nonresident pension taxation sometimes argue that it acts as a barrier to free movement of persons from one place to another. As the AARP analysis stated, "This would no doubt be true if only those who migrated paid the tax, and those who remained in the state did not. However, that is plainly not the case. The tax is levied equally on residents and nonresidents alike." [16]

Basis for Congressional Action. While the authority to tax nonresident pension income is clear, such cannot be said about the authority of Congress to enact a measure such as S. 267. There are three instances in which the Congress has limited the taxation of nonresident income. The Soldier' and Sailors' Relief Act of 1940 provides a member of the U.S. military is not to be considered a resident of a state for income and certain other tax purposes simply because he/she is stationed in the state. Similarly, 4 U.S.C. 113 provides that states in which a Member of Congress maintains an abode for purposes of attending sessions of Congress may not treat such Member as a resident or domiciliary or treat the Member's congressional pay as income for services performed in the state. Finally, the Amtrak Reauthorization and Improvement Act of 1990 (P.L. 101-322) prohibits any state, other than the state of residence, from taxing the compensation of interstate railroad and motor carrier employees derived from services performed in more than one state.

The first two of these measures has withstood judicial scrutiny.[17] In both cases, however, the judicial analysis drove in large part from prohibitions on state taxation of the federal government and its activities and instrumentalities and in the taxation of contractors doing business with the federal government. The courts noted the kinship between the service personnel and Members of Congress on the one hand, and the actual operations, functions, agencies and instrumentalities of the federal government, on the other. This is similar to the analysis employed in evaluating state taxes on federal contractors and agencies. In such cases, the courts attempt to determine whether the function or entity being taxed is an "integral part" of the federal government. While the provision enacted in 1990 has not been attacked, one could presume that the authority to limit state taxation of railroad and motor carrier employees would derive from its plenary authority to regulate interstate commerce.[18]

Neither of these situations is present with respect to the taxation of nonresident pension income. That is, there is no special employment or operating relationship between nonresident pensioners generally and the federal government (as there is with service personnel and Members of Congress.) Likewise, there is no interstate commerce at stake with nonresident pensioners. Thus, the jurisdiction of the Congress to enact a prohibition on a constitutionally authorized act of state sovereignty as proposed in S. 267 must be questioned.

This same conclusion was reached in an analysis by the Congressional Research Service.

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[15] Gist and Schorsch, *op. cit.*, p. 1.

[16] *Ibid.*

[17] The provisions of the Soldiers' and Sailors' Relief Act were challenged in *Dameron* v. *Brodhead* 345 U.S. 322 (1953). The provisions regarding congressional pay were addressed in *United States* v. *Maryland*, 636 F.2d 73 (4th Cir., 1980.)

[18] Other measures limiting state taxation authority are also generally limited to clear instances involving interstate commerce. See, for example, Railroad Revitalization and Regulatory Reform Act of 1976 (P.L. 95-473) affecting taxation of interstate railroads, or section 9125 of the Omnibus Budget Reconciliation Act of 1990 affecting the taxation of interstate airlines, P.L. 86-272 (codified as 15 U.S.C. 381) defining the terms under which state may impose net income taxes on interstate sellers of tangible personal property.

Clearly, Congress does have some authority to limit state taxation of nonresidents. Whether that authority is broad enough to justify the kind of flat ban described, however, has not as yet been conclusively established.[19]

Even if one believes Congress has the authority to legislate in this area, it must be acknowledged that enactment of S. 267 would represent a substantial expansion of Congressional authority into the area of state individual income taxation. It would constitute defining the standards under which a class of taxpayer, without a direct relationship to the federal government or without direct involvement in interstate commerce, is to be treated. Addressing the perceived needs of one class of taxpayer will undoubtedly generate demands for addressing alleged injustices being experienced by other groups. Soon, Congress could be in the business of defining more and more elements of state tax policy. Moreover, it would most likely be doing so without a strong policy backdrop against which to evaluate its choices and with a serious inability to identify and balance all the appropriate interests in each of the fifty states. Such a development would not be healthy for state tax policy or for the U.S. Congress. It seems preferable to acknowledge that this is an area of state tax policy better left to state policymakers.

CONCLUSION

The Federation of Tax Administrators and its member state tax agencies respectfully request that the Congress refrain from enacting S. 267 and other similar measures which would prohibit or limit state taxation of pension and retirement income received by nonresidents.

Enactment of S. 267 would disrupt the principle of source taxation which is the foundation of state income taxation. The courts have consistently held that states may legitimately tax income arising from sources within or services performed within a state, provided that appropriate constitutional standards are met. Those states choosing to tax nonresident pension income have met these standards by avoiding discriminatory tax treatment of nonresidents and by a system of reciprocal tax credits to avoid double taxation and attendant Due Process concerns. Beyond meeting these constitutional requirements, which no one disputes, state tax administrators believe the decision of whether or not to tax nonresident pension income is appropriately left to state policymakers who can best balance the various interests involved in the issue and blend that decision with the overall tax policy of the state.

Some may argue that nonresident pension taxation constitutes "taxation without representation." While that may have a visceral appeal, it is simply not the case. The tax imposed is legal and bears a relation to the services provided to the individual. At its most basic level, the issue of nonresident pension taxation is whether what was intended to be a tax deferral should be converted, wholly or in part, to a tax exemption if one chooses to move to a state with no income tax. Tax administrators believe this decision should be made by policymakers in the state foregoing the revenue, after a careful balancing of all appropriate interests. It is not an issue for the U.S. Congress to resolve by imposing a blanket ban on legitimate state taxation authority. Such a blanket ban will create significant inequities.

Finally, there appears to be a serious question about the authority of Congress to enact a measure such as that proposed in S. 267. It would, at the very least, constitute a substantial expansion of congressional authority and activity in the area of individual income taxation. Such a step should not be taken lightly because of the substantial long-term policy ramifications thereof for both states and the U.S. Congress.

RESOLUTION SIXTEEN

NONRESIDENT INCOME

WHEREAS, federal legislation to restrict state taxing authority is frequently proposed, ad

WHEREAS, the freedom to structure state revenue systems is essential to the operation of state governments, and

WHEREAS, restrictive federal legislation would deprive the states of badly needed revenue, and

WHEREAS, the U.S. Constitution provides adequate safeguards to insure that states do not violate principles of Due Process and other constitutional guarantees, and

[19] Robert B. Burdette, "State Taxation of Nonresidents' Retirement Income," American Law Division, Congressional Research Service, Library of Congress, March 27, 1989.

WHEREAS, the states' authority to levy a tax on nonresidents deriving income within the state has been repeatedly upheld by the U.S. Supreme Court and state courts for sound and valid reasons, and

WHEREAS, numberous measures restricting the taxation of nonresident income have been introduced into the 101st Congress now, therefore, be it

Resolved, that the Federation of Tax Administrators urge that Congress refrain from preempting, either directly or indirectly, sources of state revenue, state tax bases, or state taxation methods, and be it further

Resolved, that the Federation of Tax Administrators respectfully request Congress to reject efforts to restrict state taxation of nonresident income.

Adopted by a unanimous vote of the membership at the Annual Meeting in Charleston, S.C., on June 13, 1990

PREPARED STATEMENT OF KENNETH W. GIDEON

Mr. Chairman and Members of the Committee: I am pleased to be here today to present the views of the Administration on a number of revenue measures. We are generally concerned about the revenue costs of these proposals in view of the pay-as-you-go system adopted as part of the Omnibus Budget Reconciliation Act of 1990 (the "1990 OBRA").

1. REVEAL THE LUXURY TAX ON BOATS

Current Law

The Omnibus Budget Reconciliation Act of 1990 added various luxury taxes to the Internal Revenue Code ("Code"). Under new section 4002, if the actual retail sales price of a new boat exceeds $100,000, a 10 percent tax is imposed on the excess. The tax is also imposed on parts and accessories that are installed on a new boat within 6 months of the purchase and on the use of a boat before there has been a retail sale. The tax does not apply to boats sold for export, but does apply to new and used boats that are imported into the United States. The tax applies to sales between January 1, 1991 and December 31, 1999.

Proposal

The proposal would repeal the luxury tax on boats.

Administration Position

We do not support repeal of the luxury boat excise tax at this time. The tax has been in effect for less than 6 months, a period which coincided with the economic downturn. It is simply too early to assess what its actual impact will be in terms of effect on the industry, revenues realized, or difficulty of administration. On the last point, I might note that excises generally have been among the simplest taxes for the Internal Revenue Service to administer. Proposed regulations issued at the end of last year should be made final in the relatively near future.

2. AMEND THE TAX TREATMENT OF PAYMENTS UNDER LIFE INSURANCE CONTRACTS FOR TERMINALLY ILL PATIENTS

Current Law

Undistributed investment income ("inside buildup") credited under a contract that is a life insurance contract for tax purposes is not taxed currently to the contractholder. Section 101(a) of the Code provides further that proceeds of life insurance contracts that are payable by reason of the death of the insured are excluded from gross income. As a result, inside buildup amounts that are paid out as death benefits escape tax completely. If an insurance contract is not a modified endowment contract ("MEC"), amounts not exceeding the cash value of the policy may be borrowed tax free, and any pre-death distribution of the contract's cash value is tax free to the extent of the policyholder's basis in the contract. If a policy is a MEC, loans or pre-death distributions are treated as coming first out of income and only thereafter as recovery of basis. Consideration received from the sale or assignment of a life insurance contract is includable in gross income.

Under section 7702, a policy that is a life insurance contract under the applicable state or foreign law qualifies for the tax benefits available to life insurance if it satisfies one of two alternative tests: (1) the cash value accumulation test or (2) the guideline premium/cash value corridor test. The cash value accumulation test is satisfied if the contract's cash surrender value does not at any time exceed the net single premium that would be required at that time to fund future benefits under

the contract. The guideline premium/cash value corridor test is satisfied if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and the death benefit under the contract is not less than a prescribed statutory percentage (which decreases with the increasing age of the insured) of the cash surrender value of the contract.

The net single premium used in applying the cash value accumulation test and the guideline single premium or guideline level premiums used in applying the guideline premium/cash value corridor test are the amounts necessary to fund future benefits under the contract. Future benefits include the death or endowment benefit under the contract as well as the charges stated in the contract for providing certain "qualified additional benefits." Currently such benefits are limited to (1) guaranteed insurability, (2) accidental death or disability benefit, (3) family term coverage, and (4) disability waiver benefits. The treatment of a benefit as a qualified additional benefit therefore increases the section 7702 limitation to the extent of the discounted value of the stated charge for the benefit.

Section 7702 applies to contracts issued after December 31, 1984. For this purpose, contracts that are issued in exchange for existing contracts after December 31, 1984 are treated as new contracts issued after that date. Section 7702A, which provides a test for determining when a life insurance contract is a MEC, has a similar grandfather rule.

Proposal

The proposed legislation would amend section 101 to provide that amounts paid under the life insurance contract of a terminally ill insured would be treated as an amount paid by reason of the death of the insured and therefore excludable from gross income. A terminally ill insured is defined as an individual who has been certified by a licensed physician as having an illness or physical condition that can reasonably be expected to result in death in 12 months or less.

The proposed legislation would provide further that a "terminal illness rider," which permits the payment of benefits to an insured upon his becoming terminally ill, would be treated as a qualified additional benefit for purposes of applying the tests of section 7702 and that the addition of such a rider to an existing life insurance contract would not constitute an exchange of contracts for purposes of applying the effective date rules under sections 7702 and 7702A.

The bill also provides that applicants for or recipients of certain public assistance benefits may not be required to exercise any right to receive an accelerated death benefit as a condition of eligibility for such public assistance benefits.

Administration Position

We oppose the expansion of section 101 as proposed. Section 101 currently provides for the exclusion from income of amounts paid under a life insurance contract by reason of the death of the insured. We believe the fundamental family security rationale for the tax-favored treatment of the inside build-up in life insurance would be undermined if broadened in the manner proposed.

As we understand the proposal, there is no restriction on the use to which tax-free proceeds could be put. While the circumstances under which the withdrawal could be made compel our sympathy, we should recognize that any such expansion of section 101 will bring forward proponents of further expansions for similar needs—such as long-term care—or other worthy goals, such as education or housing. Such expansions and the potential adverse revenue consequences they entail would undoubtedly place section 101 under severe pressure. It is a journey we should not begin.

The goal of endeavoring to assist the terminally ill is a sympathetic one. Under the bill, however, assistance would not be equally available to all terminally ill persons. Only those terminally ill persons holding life insurance contracts at the time of their illness could avail themselves of the benefits, and the benefits would be greatest for those able to afford large life insurance policies.

Finally, the trigger proposed for early payment—a physician's certification that the individual has less than one year to live—raises serious problems of administration. "Audit" of such a certification would be difficult, to say the least. Yet if the standard is effectively unauditable, compliance concerns are certain to arise.

3. INCREASE THE AMOUNT OF BONDS ELIGIBLE FOR CERTAIN SMALL GOVERNMENTAL ISSUER EXCEPTIONS AND MODIFY OTHER TAX RULES WITH RESPECT TO BONDS ISSUED BY STATE AND LOCAL GOVERNMENTS

Current Law

The Internal Revenue Code contains restrictions on the issuance of tax-exempt bonds by State and local governments designed to prevent inappropriate arbitrage profits by issuers of such bonds and to prevent the benefits of tax exemption from inuring to other than intended beneficiaries as described in the Code. A requirement to rebate arbitrage was imposed on virtually all tax-exempt bonds by the Tax Reform Act of 1986. Among these restrictions are the following:

(i) Small governmental issuers with general taxing powers are exempt from the arbitrage rebate requirement only if they issue less than $5 million of governmental bonds during a calendar year. This is commonly referred to as the "small issuer exception" to arbitrage rebate.

(ii) A 2-year spend-down exception to the requirement to rebate arbitrage was enacted as part of the 1989 OBRA. This exception generally provides that bond issues used to finance construction projects are not subject to the rebate requirement if the proceeds are expended within 2 years of the date of issue of the bonds at rates specified in the statute (at least 10 percent within 6 months, 45 percent within 12 months, 75 percent within 18 months). The 2-year spend-down exception to arbitrage rebate is generally effective for bonds issued after December 19, 1989.

(iii) Section 265(b)(3) currently permits an issuer that reasonably anticipates issuing $10 million or less of governmental and qualified 501(c)(3) bonds during a calendar year to elect to exclude such issues (sometimes referred to as "bank qualified bonds") from the interest disallowance provisions of section 265(b)(3). Section 265(b)(3) provides generally that banks may not deduct interest expenses attributed to tax-exempt bonds under a formula provided in the statute.

(iv) Section 141(b)(3) of the Code currently prohibits more than 5 percent of proceeds of a governmental bond issue from being used for a private business use that is unrelated to the governmental use of the facility or that is disproportionate to the governmental use of the facility. This provision effectively reduces the 10 percent private business use threshold to 5 percent when the private business use is not related to the governmental use of the facility or the private use is disproportionate in multi-facility projects.

(v) Failure to restrict the yield on the investment of bond proceeds to the bond yield as required by section 148 may not be remedied by rebating the arbitrage to the Federal Government.

(vi) Under section 149 of the Code an issuer must generally rebate 100 percent of the arbitrage it earns to the Federal Government.

(vii) Certain advance refunding bonds the proceeds of which are invested in substantially higher yielding investments currently are not described as a device in income tax regulations under section 149(d).

Proposals

The proposal would remove or liberalize certain existing restrictions on tax-exempt bonds. The bill contains 7 specific proposals which may be summarized as follows:

(i) The $5 million small issuer exception from rebate in section 148(f)(4) would be increased to $25 million. The requirement in section 148(f)(4) that governmental units must have general taxing powers to be eligible for the exception would be eliminated. This would permit governmental units such as special service districts, authorities and similar entities with limited or no taxing powers to be eligible for the exception. However, subordinate entities would still be required to be aggregated for purposes of the exception.

(ii) The 2-year spend-down exception to rebate in section 148(f)(4)(iv) would be made retroactive to the effective date of the Tax Reform Act of 1986 (generally August 15, 1986). The 2-year spend-down exception was substantially amended in the 1990 OBRA. The provision would not permit refunds of rebate paid prior to the date of enactment of the bill.

(iii) The small issuer exception (or "bank qualified bond" exception) from the interest expense disallowance provision of section 265(b)(3) relating to financial institutions would be increased from $10 million to $25 million.

(iv) The 5 percent test for private business use not related or disproportionate to government use financed by the issue in section 141(b)(3) would be repealed.

(v) Section 148 would be amended to permit the payment of rebate in lieu of restricting yield on investment of bond proceeds. Currently section 148 requires yield

restriction as well as rebate, and a failure to yield restrict when required cannot be cured by rebating the improperly earned arbitrage. This provision would not apply to advance refundings. Treasury would be given authority to require yield restriction in circumstances in which the yield restriction requirement applies for purposes other than preventing the earning of arbitrage.

(vi) Section 148 would be amended to reduce the amount of rebate from 100 percent to 90 percent of arbitrage earned.

(vii) Define certain advance refunding bonds the proceeds of which are invested in substantially higher yielding investments as a device under section 149(d).

Administration Position

(i) We oppose increasing the $5 million small issuer exception from rebate to $25 million. The proposal would be expensive and would defeat in part the policy of discouraging arbitrage motivated transactions. We recognize that an argument can be made for increasing the small issuer exception to $10 million to conform it to the $10 million small issuer "bank qualified bond" exception under section 265(b)(3). However, absent an acceptable offset, we do not support even such a limited expansion.

(ii) We oppose the proposal to make the 2-year spend-down exception to rebate retroactive. Our opposition is based both on our general policy of opposing retroactive tax legislation and the fact that the proposal would provide a windfall to many issuers. Bonds issued after 1986 and before the effective date of the 2-year rule were structured and sized to take into account the rebate requirement.

(iii) We oppose the proposal to increase the $10 million bank qualified bond exception to $25 million. There is no justification for granting financial institutions additional relief under section 265.

(iv) We do not oppose the proposal to repeal the 5 percent private business use test provided there is an acceptable revenue offset. This part of section 141 is often misunderstood by issuers and not easily administrable by the Internal Revenue Service. Repeal would accomplish significant simplification without sacrificing significant policy objectives.

(v) We are in general agreement with the notion that it should not be necessary to apply both yield restriction and the arbitrage rebate requirement to the same bond issue. There may, however, be circumstances in which arbitrage rebate alone may not be sufficient to prevent issuances with a significant purpose of earning arbitrage. Accordingly, were the proposal revised to include residual, prospective Treasury regulatory authority to impose yield restriction (without a rebate alternative) where necessary to prevent abuse, we would support the change. We believe that the provision if so revised would not lose revenue.

(vi) We believe this proposal merits serious consideration. However, we have not completed our own analysis to determine what the optimal percentage division might be and whether the proposal involves significant revenue consequences. Currently, there is no economic motivation for an issuer to maximize or even achieve efficient investment yields on bond proceeds subject to the rebate requirement. This is so because once the investment yield equals the bond yield, the issuer has no motivation to earn a higher yield because earnings attributable to the yield in excess of the bond yield must be paid to the Federal Government in the form of rebate. While the income tax regulations require that bond proceeds be invested at arm's length, in practice this requirement is extremely difficult if not impossible to enforce.

A relaxation of the arbitrage rebate requirement of the sort contemplated by the rule raises significant policy issues as well since it would in effect permit—and even encourage—issuers to achieve some, though quite limited, arbitrage. We therefore recommend that this issue be formally studied to determine: (i) whether such "permitted arbitrage" would undermine the objectives of the arbitrage rebate provision, and (ii) what division of arbitrage profits would provide an incentive for issuers to maximize investment yield without encouraging them to issue bonds for the purpose of realizing an arbitrage profit.

(vii) We support the proposal to define certain advance refunding bonds as a device under section 149(d). Investment of "released revenues" in forward purchase contracts at an unrestricted yield in the manner proscribed by this provision results in the earning of arbitrage.

4. MODIFY THE TAX-EXEMPT BOND AND DEPRECIATION RULES WITH RESPECT TO INFRASTRUCTURE FACILITIES

Current Law

Infrastructure facilities, such as sewage, solid waste disposal, hazardous waste disposal, and facilities for the furnishing of water may be financed as exempt facility

private activity bonds. As private activity bonds, these obligations are subject to restrictions which include aggregate dollar limitations of issues by state volume caps, treatment of interest thereon as a preference item for purposes of the alternative minimum tax, and the limitations contained in section 147 including—limitations on substantial users, 120 percent of economic life requirement, limitations on land and existing property acquisitions, limitations on skyboxes, airplanes and gambling establishments, public approval requirements and the 2 percent cap on costs of issuance. In addition, private activity bonds are not eligible for the 2-year spend-down exception from arbitrage rebate, generally cannot be advance refunded, and are subject to "change in use" restrictions under section 150(b) of the Code.

Proposal

The bill would accord bonds issued to finance "infrastructure facilities" the same treatment that non-private activity governmental bonds currently receive under the Code. Accordingly, infrastructure bonds would generally not be subject to the volume cap and other restrictions described above. (Governmentally owned solid waste disposal facilities are exempt from the volume cap under present law.) Accordingly such infrastructure bonds would also be eligible to be advance refunded.

(i) Infrastructure bonds would be defined as bonds issued to provide infrastructure facilities "which are available for the ultimate use of the general public (including electric utility, industrial, agricultural, commercial, nonprofit, or governmental users)." Infrastructure facilities would include: sewage facilities, solid waste disposal facilities, hazardous waste disposal facilities, facilities for the furnishing of water and facilities which are constructed, reconstructed, rehabilitated, or acquired for the purpose of achieving compliance by a state or local government with Federal statutes administered by the EPA. Sewage, solid waste disposal, hazardous waste disposal, and water furnishing facilities are currently permitted to be financed as exempt facility private activity bonds under section 142. These categories of exempt facility bonds are repealed under the bill. The bill would liberalize the definition of hazardous waste disposal facilities by deleting the limitation that disposal be only by incineration or entombment and by requiring that the facility be "ultimately" used by persons other than the owner, operator or related persons.

(ii) The bill would also liberalize the 2-year exception to the arbitrage rebate requirement by providing a 3-year spend-down exception to the rebate requirement in addition to the 2-year exception. The 3-year exception would apply to any bonds other than private activity bonds and tax and revenue anticipation bonds and; unlike the 2-year exception, would not be limited to construction issues. The 3-year exception would require expenditure of bond proceeds as follows: 20 percent in the first year, 50 percent in the second year, and 95 percent in the third year. "Soft costs" such as costs of issuance would be included in the spend-down requirement if not made more than 1 year after the date of issue of the bonds.

(iii) The bill would also amend section 168(e) (relating to depreciation) and would classify infrastructure facilities as 7-year ACRS property with a 10-year ADR midpoint to the extent such facilities do not already have a shorter recovery period. Also, infrastructure facilities financed with tax-exempt bonds would not be treated as "tax-exempt" use property for purposes of section 168(h).

Administration Position

(i) We oppose treating infrastructure bonds as governmental bonds. This provision would result in a significant increase in the amount of tax-exempt bonds issued.

(ii) We oppose the proposed 3-year exception to arbitrage rebate. The proposal was considered and rejected when Congress reached an agreement with respect to the 2-year spend-down exception to arbitrage rebate.

(iii) We oppose treating infrastructure facilities as 7-year ACRS property which is exempt from treatment as tax-exempt use property. There is no justification for allowing accelerated depreciation on such facilities in addition to the implicit Federal subsidy arising from tax exemption on the indebtedness.

All three items would result in significant revenue loss.

5. TREAT BONDS ISSUED FOR SECTION 501(C)(3) ORGANIZATIONS IN A MANNER SIMILAR TO GOVERNMENTAL BONDS

Current Law

If proceeds of a bond are used in the trade or business of a 501(c)(3) organization, the bond is treated as a private activity bond. Under section 145, qualified 501(c)(3) bonds may be issued as tax-exempt private activity bonds subject to a number of limitations. The most significant limitations with respect to qualified 501(c)(3) bonds are: (1) the amount of qualified 501(c)(3) bonds outstanding for non-hospital uses

cannot exceed $150 million per 501(c)(3) organization, (2) if proceeds of qualified 501(c)(3) bonds are used to provide certain residential rental housing for family units, the housing units must meet the low- and middle-income targeting requirements of section 142(d)(3) under section 147, the maturity of the bonds cannot exceed 120 percent of the economic life of the property, (4) no portion of the bond proceeds may be used for skyboxes, airplanes or gambling establishments, (5) the bonds must be approved by the public, (6) costs of issuance financed with bond proceeds may not exceed 2 percent of the amount of the bonds, and (7) "change in use" restrictions with respect to facilities required to be owned by a governmental unit or a 501(c)(3) organization under section 150(b).

Proposal

The proposed legislation would generally treat bonds the proceeds of which are loaned to or used by 501(c)(3) organizations for their exempt 501(c)(3) purposes in the same manner as governmental bonds, effectively repealing the limitation on such bonds added in the Tax Reform Act of 1986. The provision does not apply to bonds the proceeds of which are used by 501(c)(3) organizations in unrelated trades or businesses. All of the restrictions under section 147 of the Code currently applicable to qualified 501(c)(3) bonds would no longer apply to such bonds other than the restriction under section 147(b) that the bonds not have an average maturity in excess of 120 percent of the average economic life of the bond-financed property and the requirement under section 147(f) that the bonds be approved by the issuing governmental unit after a public hearing or referendum. Also, the restrictions under section 150(b)(5) of the Code with respect to "change in use" of facilities required to be owned by governmental units or 501(c)(3) organizations would be retained. Additionally, bond proceeds used by a 501(c)(3) organization to provide certain residential rental housing for family units would remain private activity bonds and would be subject to the low- and middle-income targeting requirements of section 142(d).

Administration Position

We oppose this proposal. It would significantly expand a large class of tax-exempt obligations and would result in significant revenue loss to the Federal Government.

Prepared Statement of Senator Bob Graham

Mr. Chairman and members of the Committee, thank you for allowing me to testify today on the impact on Florida of the luxury tax on boats.

The luxury tax on boats, created by last year's budget deficit package, was intended to affect the wealthiest Americans. Instead, potential buyers decided to postpone their purchase, buy used boats not subject to the surtax, or buy their boats in another country. This has caused serious damage to the manufacturers, retailers and workers in America's boating industry, particularly in my home state.

Mr. Chairman, in Florida, manufacturing and retail sales of recreational boats is a $3.5 billion annual industry. Since the luxury tax went into effect on January 1, this industry has shown a marked decline. A study of 17 Florida boat dealers and custom manufacturers revealed that boat sales declined nearly 90% in the first quarter of 1991 compared to the first quarter of 1990. These retailers have had to lay off nearly 30% of their work force.

No one can deny that the recession has had a devastating effect on the boating industry. Throughout Florida, boat dealers admit that business was bad. Yet they could weather the recession. They could not survive this tax. We are not talking about the demise of large, bureaucratic corporations. These retailers and manufacturers are mostly family-owned and operated proprietorships with less than 100 employees.

This tax is also hurting the cities and towns where the boat manufacturers are located. Wellcraft Marine, established in 1955 in Sarasota, Florida, produced more boats in 1988 than in their entire first decade of existence. Last year, however, Wellcraft's employment decreased from 2,000 to 800. Because 2 other major boat manufacturers in Sarasota declared bankruptcy last year, 4,000 people in that community have lost their jobs. The loss of manufacturing jobs is particularly harmful since these jobs generate employment in other affiliated industries, such as service, supply and outfitting. A U.S. Chamber of Commerce study estimates that for every 100 manufacturing jobs, a county earns $2 million in gross income. At this rate, Sarasota County has lost $80 million.

This is just one example. With 626 boat manufacturers, the most in any state, this tax has had the same consequences in other communities throughout Florida. In fact, the marine industry estimates Florida would lose more than $3.5 million in

sales tax revenue for just the first quarter of 1991. States, cities and towns are suffering from this tax.

The luxury tax on boats has not just lost jobs and state revenue, but it could also lose revenue for the federal government. The Joint Committee on Tax estimates this tax will raise only $3 million this fiscal year. This is less than the $3.5 million Florida could lose in sales tax revenue in just 4 months. On April 23, the *Wall Street Journal* reported that the Internal Revenue Service could spend two to three times this amount on collection costs. Several Members of Congress have requested a General Accounting Office study to examine this claim. These administrative costs, combined with unemployment compensation and lost corporate and payroll tax revenues, could mean that this tax will actually cost taxpayers money.

While Americans are losing money, Bahamian boat builders are seeing profits soar. Rather than pay a 10% tax in West Palm Beach, a yacht buyer can take a 20 minute flight to the Bahamas. In fact, Bahamian Prime Minister Pindling recently cut import taxes to specifically encourage such purchases.

It is obvious that the people suffering from this tax are NOT the luxury yacht buyers. They can wait to buy their yachts. Boat builders, retailers and their employees cannot wait. And Congress should not wait to repeal this tax.

I want to thank Senator Breaux and my fellow Floridian, Congressman Shaw, for their leadership in repealing this tax. I urge my colleagues to join me as a cosponsor of this proposal. I hope this misguided tax will be repealed quickly.

PREPARED STATEMENT OF ROBERT P. HILL

My name is Bob Hill and I am Executive Vice President of The Prudential Insurance Company of America. I appreciate the opportunity to testify in support of S. 284, a measure to aid and comfort the terminally ill. By enacting this legislation, you will ensure that the death benefits terminally ill policyholders receive from their life insurance policies are not taxed, making their last days more comfortable. The Prudential strongly supports this legislation and urges that it be enacted as quickly as possible.

Before I discuss the importance of S. 284, I would first like to tell you a little about The Prudential's accelerated death benefit program—how it works, its purpose, and how it has touched the lives of some of our policyholders.

As part of a program that we call the Living Needs Benefit, a terminally ill policyholder can receive the death benefit under his or her life insurance policy while still alive. To obtain this early payment of the death benefit, the policyholder must provide a physician's certification that the insured is expected to die within six months. The amount the policyholder receives is the present value of the death benefit, which we would expect to pay six months in the future. Let me emphasize that our purpose is to pay the terminally ill person the present value of his or her policy. The Prudential does not make any money on this program.

Forty-nine states have approved our Living Needs Benefit. The Living Needs Benefit has been made available at no additional cost to over 3 million of our existing policyholders and is available on most of our newly issued policies.

The Prudential's Living Needs Benefits program has several advantages.

First, we all know the financial and emotional devastation that a final illness can cause. We think that easing the financial strain of such an illness makes an insured's last months of life more comfortable and dignified. Accelerating death benefits allows us to make funds available to the terminally ill to pay for the costs of a final illness and provides terminally ill insureds more choice with respect to their lifestyle and care.

Second, by accelerating death benefits, we can provide this help to terminally ill policyholders without cost. The policyholder gets the present value of his policy. Because death is imminent, this value is simply the present value of the death benefit payable in six months. This generally works out to about 96 percent of the death benefit—virtually all policyholders would get far less if forced instead to surrender their policies for their cash surrender values. We can pay this amount without harming our other policyholders since we are simply paying the present value of the amount we would have to pay soon anyway.

Because our program also allows people to use their Living Needs Benefits for any purpose, including payment of the costs of a final illness, dependence on medicaid and other government health programs can be reduced.

Since we began paying Living Needs Benefits 16 months ago, we have paid 135 claims for terminally ill people, for a total amount of about $8.5 million. Most are

cancer or AIDS victims. While the number of claims has been small, the importance to each individual involved cannot be overstated.

For example, one of Prudential's policyowners, a 54 year old former machine operator, was terminally ill with cancer when he received the Living Needs Benefit. His illness had forced him to stop working, and the family's financial resources had been drained by medical expenses. His wife had this to say to a reporter about the Living Needs Benefit:

> "This program is a godsend. We were able to pay for medication, pay bills which were getting way behind and pay off our second and third mortgages. We have one less worry to deal with."

She described her husband as having been "down and distraught," but said he became more relaxed after he realized that his family's financial situation had improved.

An Iowa man, a truck driver in his 50's, who was terminally ill, used his Living Needs Benefits to pay off his home mortgage, settle all his financial affairs, pay for his funeral, and arrange for his wife's financial security after his death.

Another policyholder, a 41-year old Californian woman, who was terminally ill with lung cancer, used the Living Needs Benefit to save her home from foreclosure and to pay for a trip back east to visit her mother one last time.

Each of these people was able to turn to the Living Needs Benefit to provide funds when there was literally no other money available to them.

The Prudential is pleased that you are considering S. 284, which we believe is very important to the future of accelerated death benefit programs. S. 284 would encourage the provision of accelerated death benefits by making two important clarifications of the treatment of these benefits.

First, S. 284 would clarify that accelerated death benefits for the terminally ill are not includable in taxable income. Section 101 of the Code excludes from income amounts paid by reason of death. Thus, these benefits would clearly be excludable if paid upon death. From tax and social policy standpoints, it makes sense to exclude these amounts when paid shortly before death as well. Also, from an insurance point of view, the risk insured against—that of premature death—has matured where an insured is determined to be terminally ill and is expected to die within a period of up to 12 months.

Second, S. 284 would clarify that holders of policies with accelerated death benefits options would not be required to claim accelerated death benefits in order to be eligible for Medicaid or SSI. Benefit payments actually received pursuant to the Living Needs Benefit option would, of course, be considered in applying eligibility asset and income tests, thereby reducing dependence on federal assistance programs. However, it is important to codify the current interpretation of the law that the mere right to the acceleration would not cause the potential benefits to be counted for eligibility purposes. Policyholders must have very compelling arguments that current law already provides an exclusion for these amounts, and without the exercise of the option the death benefits clearly would be paid on a tax-free basis shortly anyway. Under current law an accelerated death benefit option is not considered for Medicaid and SSI eligibility purposes unless and until it is paid. However, with the bill's clarifications, companies will be further encouraged to offer accelerated death benefits, thereby improving the quality of life for the terminally ill.

The Prudential strongly supports S. 284 and thanks you for considering it.

Prepared Statement of William C. Hoffman

The members of RESIST of America and The members of The Coalition shown in Attachment A urge The Senate to pass Senate Bill S. 267.

ISSUE

Do we still have "TAXATION WITHOUT REPRESENTATION" in America? YES, WE DO! The taxation of nonresident pensions by the states is a prime example of "TAXATION WITHOUT REPRESENTATION."

How can a nation that was formed over The issue of "TAXATION WITHOUT REPRESENTATION" allow this to happen? **BECAUSE IT IS THE BEST KEPT SECRET IN AMERICA!** No one was told about this unfair tax. This tax interferes with our right to travel across the United States of America and live where we choose without a financial penalty.

BACKGROUND

Several states now tax nonresident pensions. There are, in total, about 40 states with source tax laws and each of them could implement this tax on nonresident pensions. I will frequently use California as an example during this presentation for three reasons:

1: They are the most aggressive State
2: They often lead the Nation in new trends
3: We understand their nonresident laws and procedures better.

The 40 states mentioned before, tax nonresidents on various types of source income. There are legitimate reasons for some of these taxes. An individual could operate a business or work in a nonresident state. In these cases, the resources of the state are being used or jobs are taken from the residents. If the nonresident doesn't want to pay these taxes, they can remove the business from the state or not work in the state. They have a choice.

Nonresident taxation of pensions is different; because unlike a business, job, or investment, the pension tax debt can not be removed from the state. The retiree is trapped for the rest of their lives by the state in "financial Slavery."

States can raise nonresident taxes whenever they like. What can nonresidents do about it? NOTHING!

What services do we get as nonresident taxpayers? NONE! We can't use schools, or even buy a fishing license at resident rates.

What do we get from the government of the taxing state? NOTHING!

THIS TAX HITS RETIREES HARD!

Imagine:

An elderly lady in Nevada that makes between $12000 and $13000 a year. She isn't rich, but she is surviving. Then the mailcarrier delivers a notice from California that says she owes taxes on her pension, plus penalty and interest. She can't believe it; and being honest, she tells California that she has never paid. The result was they calculated her tax debt from 1978 till the present. She now owes about $6000.

Imagine:

A retired man from California, whose wife died, meets a lady, marries her and moves to New York because she is still working there. He discovers that he not only must pay California taxes on his pension for the rest of his life, but must include his out of California income and his new wife's income. He pays New York much less because they give a large exemption for resident pensions.

Imagine:

A lady in Texas who just received a bill from CA for more than $24000.

Unfortunately, these are not imaginary cases. They are just a few real cases out of thousands in our files.

STATES POSITION

Some states correctly assume pensions are intangibles, similar to savings accounts. Others claim pensions are deferred income.

Defining pensions as "deferred income" is an indiscriminate use of the English language and law. Income that is deferred should be paid unconditionally, either to the retiree or to their heirs. Pensions clearly do not meet the requirements of deferred income. If you are unfortunate and die one day before you retire, you or your heirs receive only your own contributions plus a small amount of interest. You receive none of the so called "deferred income."

These states claim that benefits were received when the retirees were earning the pension. Therefore they owe taxes for the rest of their lives, and do not deserve any additional benefits.

There is a fallacy to this argument. Consider two similar retirees. One decides to remain in the state where the pension was earned and the other moves to another state. The resident pays taxes, but continues to receive benefits from the state, and can vote, petition and otherwise be represented by the government of that state. The nonresident pays taxes, but receives *nothing. Didn't the retiree who remained in the state also get benefits while they were earning their pension? ISN'T THIS DISCRIMINATION? HOW CAN THIS BE EQUAL TREATMENT?*

Most retirees paid taxes on contributions to their pension plans. Apparently, Companies, Federal, and State agencies did not pay taxes on their contributions to pen-

sion plans or accrued interest. Before the publicity that RESIST of America initiated, no one was informed, by either their State or employer, about nonresident taxation of retirement income. Why weren't we informed about this **unfair** tax that would lead to "Taxation Without Representation" in the future? Why weren't options offered to the employees, such as 401K Averaging Plans? The only reason for deferring taxable income is to pay fewer taxes on the income later. Nonresident retirees might pay significantly more taxes instead of less. It is particularly frightening to speculate on how high nonresident taxes could become in the future. When a State needs more income, they can raise these taxes at their discretion and a nonresident can do **nothing** about it. The retiree cannot vote, petition, receive benefits or enjoy governmental protection from the taxing State. This situation is intolerable.

It was this **unfair** tax that prompted me to form RESIST of America in July of 1988. RESIST of America is a nonprofit organization that was incorporated July 28, 1988. The only goal of RESIST of America is to end the tax on nonresident pensions by the states. RESIST of America is a "grass roots" organization that operates entirely through volunteers. No one in our organization gets a salary. Our organization is not, however, against fair taxation with representation.

CALIFORNIA HAS IT BOTH WAYS

California has obtained (from their point of view) delightfully contradictory court rulings.

Borchers—Baustian

The Borscher case was tried in the district court 2 of Los Angeles, CA. It involved a man who earned his pension in Illinois and moved to California to retire. Borscher claimed that he didn't owe California taxes on his pension income because the SOURCE of his pension was Illinois. California disagreed. Borscher lost after a ten year court battle.

The Baustian case involved a man who earned his pension in California and retired to another State. California claimed that he owed nonresident taxes on his pension because the SOURCE of his pension was California. This decision was made by The State Board of Equalization. The cases occurred about the same period.

As a spokesperson for the California FTB cheerfully acknowledges, residents can be taxed on all income, regardless of its source; nonresidents are taxed on the source regardless of residence.

To make matters worse, California hired collection agencies that use "Gestapo Tactics" to harass and threaten Senior Citizens for the collection of these unfair taxes. They also offer rewards for information on delinquent taxpayers. Other states will probably follow California's lead.

INCOME EARNED IN OTHER STATES ALSO TAXED

There is another point that has aggravated Seniors Citizens. Several States (particularly California) use total income earned (including income earned in other States) to establish the highest rate for taxing pensions. Even so, they claim they do not tax out of State income. However, any increase in taxes as a result of including non-California income is clearly a tax against that income.

This procedure, causes additional inequality between retirees. A retiree that supplements their income through investments, can decrease their tax liability by investing in items (Federal Securities) that states cannot tax. Those retirees that must work to supplement their income have no options and must include this income. As a result, the retiree that works pay more taxes than the retiree that invests, even if their total income is the same.

CALIFORNIA, PERHAPS OTHER STATES, TAX NONRESIDENT, MILITARY PENSIONS

Some believe that California does not tax the nonresident pensions of military personnel. Don't you believe it. Check California tax forms 1031 and 1032. California gives an exemption for military personnel, but the maximum exemption is a generous $40.00 per year. Other states have not answered the question of whether or not they tax military pensions. We suspect they do.

CONSTITUTIONALITY OF NONRESIDENT TAXES

One of the first officials contacted by our organization about this issue was The Attorney General of Nevada. It was our hope that he would challenge the constitutionality of the nonresident tax on pensions by the states. We knew that it was un-

constitutional for a citizen to sue a state in a Federal court. Unfortunately, Brian McKay, who was Nevada's Attorney General then, told us that the U. S. Supreme court had upheld the nonresident taxes about 70 years ago. He sent us the Michigan State Law review, which discussed many cases covering this general issue. He recommended that we try to get Federal Legislation passed. Research into other court cases and investigation of The California State Law Review confirmed his position.

Can we solve this problem at the State level?

There are some Senators that believe that we should work though the states and organizations like The Multi-State Tax Commission to end this tax on nonresident pensions. We have tried. It is impossible to sway State Legislators when you are not represented. New Jersey is the only state that was convinced to stop taxing non resident pensions. This success occurred due to the efforts of The National Association of Retired Federal Employees (NARFE) and due to a study by New Jersey that the collection of these taxes was not economical.

Our efforts with California have been futile to say the least. Last year, The California Legislature introduced two bills to prevent or limit the taxation of nonresident pensions. AB-3976, which would completely end this unfair tax and AB-3963, which would give a $20,000 credit to nonresidents, but income earned in other States must still be used to determine the tax rate. AB-3963 also contained a "sunset clause" which would automatically repeal the law 6 years after enactment.

Trice Harvey, an Assemblyman from Bakersfield, invited me, Pierce Powers (National Association of Retired Federal Employees—NARFE), Elton Hipport also from NARFE, and Douglas Baldwin, representing The Air Force Association to testify before the Revenue and Taxation Committee for AB-3976.

Johan Klehs, Chairman of this committee (District San Leandro) refused to let us testify, claiming there was not enough time and that we were "out of order." The testimony for and against the previous issue, to grant tax exempt status for businesses that grow ostriches for food involved less than a dozen people, and took more than two hours (not counting two hours for the ostrich barbecue).

Our issue involves millions of Senior Citizens as well as the young people in the State. Clearly, we were faced with a "stacked deck." The committee has every right to oppose our position; however, there is never a reason to be rude and inconsiderate to anyone. Johan Klehs treated us like people without representation.

This year AB 1513, SB 427, and AJR 25 were introduced. The two bills would repeal the tax on nonresident pensions, and the joint resolution urges The United States Congress to pass the bills that prohibit this tax. This year it was Dick Millington (Regional Vice President—NARFE) who received the rude treatment.

I have subsequently written a letter to The Speaker of The California Assembly, Willie Brown, and suggested a plan that would end "TAXATION WITHOUT REPRESENTATION" and yield California more income.

WE NEED FEDERAL LEGISLATION! THE CONGRESS OF THE UNITED STATES IS OUR LAST HOPE!

We are asking you, The Congress to help us end this terrible injustice to our Seniors and our Future Seniors. The issue of taxation of nonresident pensions by the states affects every American. Even if a citizen does not have a pension or if they never leave the state where the pension is earned, they are affected.

Many states give credits or rebates to retirees that pay taxes to another state. If a state does, then the taxpayers of that state are paying for the benefits, services, and government for these retirees. The taxes paid by the retirees, that should help defray the cost of their benefits, services, and government, are instead paid to their former state. That state doesn't give anything to the retirees or the resident state's economy. Even if the resident state does not give credits or rebates for taxes paid to another state, their citizens still lose. The money paid to another state by the retirees is not available for expenditure in your state.

There is a better way. Taxpayers should pay taxes only to their state of residence, where they receive benefits, services and government, where they have the right to vote, petition, and otherwise influence their representatives.

Three bills have been introduced into The House of Representatives to stop states from taxing nonresident pensions, (H.R.431, H.R.1531, and H.R.1655).

H.R. 431 and H.R. 1531 are similar to The Senate Bill S.267. The main difference is that S. 267 includes pensions and other Retirement income instead of just pensions. The difference is important. California has recently introduced legislation to tax Social Security. Some other States have already done this. Without the clause, "other Retirement Income," we could be back where we started even if The House Bills passed. House bill H.R. 1655 is more complex, but does have some favorable attributes:

1. States must inform employees each year about his or her nonresident tax policies.
2. States must offer a lump sum settlement if the conditions of 1. are met and the retiree leaves the state.
3. Income earned in other states cannot be taxed.

DOES S. 267 COST THE FEDERAL GOVERNMENT?

The Federal Government should realize a slight increase in tax revenue if S. 267 passes, because those retirees that still itemize on their Federal taxes would have fewer deductions.

States would probably not lose income either. If we do not pass S. 267, it is ironic that the most aggressive state, California would lose. California is still the second largest retirement state behind Florida. When the other Source tax States, realize that California is stealing money from their economy, you can bet they will retaliate and impose taxes on their retirees that move to California. It is difficult to predict which state would lose the most, but one situation is easy to predict. If taxes are paid to the State of Residence, where the Retiree can vote, petition, receive services and benefits, everyone gains, including the states.

We urge you to pass S. 267 and end the tyranny of "TAXATION WITHOUT REPRESENTATION," without a financial loss to the Federal Government and, we believe, without a loss to the states.

Stop this terrible injustice to our Senior Citizens and to all Americans.

ATTACHMENT A

The following is a partial list of organizations that have joined RESIST of America in a coalition. The goal of the coalition is to end the taxation of nonresident pensions by the states. These organizations represent millions of people.

William (Bill) C. Hoffman, President, RESIST of America, 2440 Ash Canyon Rd., Carson City, NV 89703, (702) 883-8620

Air Force Association
Air Force Sergeants Association
Airline Pilots Assn.
American Assn. of Foreign Service Women
AMVETS
Assn. of Military Surgeons of the US
Association of the US Army
Commissioned Officers Assn. of the US Health Service, Inc.
Common Cause
COSSO—Council of Sacramento Senior Organizations
CWO & WA Assn., US Coast Guard
FAIR (Represents 34 Organizations)—Fund for Assuring an Independent Retirement
Federal Managers Assn.
Fleet Reserve Association
Marine Corps League
Marine Corps Reserve
McDonald County Unit of the Retired Teachers Assn.—MO
NARFE—National Assn. of Retired Federal
National Assn. For Uniformed Services
National Assn. of Postal Supervisors
National Guard Assn. of the USP
National Military Family Assn.
National Taxpayers Union
Naval Reserve Association
Navy League of the US
Nevada Taxpayers Union
Non-Commissioned Officers Assn.
Reserve Officers Association
SCAN—Senior Co-operative Alert Network
Society of Medical Consultants
The Retired Enlisted Association
The Retired Officers Association
US Army Warrant Officers Association
US CG & Chief Petty Officers Assn.

Prepared Statement of Kay Bailey Hutchison

INTRODUCTION

Good morning Mr. Chairman and members of the Committee. I am Kay Bailey Hutchison, State Treasurer for the State of Texas. I appreciate this opportunity to participate in hearings on legislation designed to relieve state and local governments of the costly burdens imposed by the Tax Reform Act of 1986.

THE GREAT NEED FOR INFRASTRUCTURE INVESTMENT

Over the last decade, states have faced growing budgetary constraints due to limits on public taxing and spending, and shrinking budgetary surpluses. These pressures on state and local budgets have led these governments to continually defer needed infrastructure investment until the time their budgets could better ac-

commodate them. But this can result in a "fiscal time bomb" which will explode when an increasing number of deferred projects will *have* to be paid for. Studies estimate national infrastructure needs have already reached the range of $64 to $118 billion (1982 dollars). These projects should be deferred no longer.

Texas, which has the largest number of highway miles in the nation, estimates the need for over $40 billion over the next 20 years to cure road deficiencies and respond to growth. Bridges are also a major problem. Texas local governments have approximately 10,000 bridges which are judged to be obsolete or structurally deficient—this translates into the need to replace or repair over 56 million square feet of bridges in the state.

In addition to the need to repair aging infrastructure, states and localities *must* comply with court-ordered improvements to school and prison systems and provide desperately-needed water and wastewater systems.

The Socorro School District of El Paso is a prime example of the problems Texas is facing as it attempts to adequately fund education. The Socorro School District is one of the fastest growing districts in the United States. Due to the growing immigrant population, the number of students has grown 14% per year. The district has just completed 3 new schools with 2 more on the way this year. But, as they open new schools, they must also open portable buildings for those schools to accommodate their growing student population.

Water and wastewater projects are also of paramount importance along the Texas-Mexico border. Cameron Park, the largest colonia in Cameron County (north of Brownsville), consists of 753 housing units with 3,690 residents. Local health officials claim this colonia needs an adequate sewage treatment facility to help curb disease. The City of Socorro, which has the largest concentration of colonias in the state, has a population of 22,000—87% of whom live below the national poverty level. One-third of this area is not served by a water system; those not served rely on hauled water or shallow brackish groundwater. There are no sewers in this area and, as a result, there is an incidence of gastrointestinal disease which is three to four times the national average.

These types of projects must be completed to provide essential services. But state and local budget problems leave little room for these projects.

INCREASING RELIANCE ON DEBT FINANCING

According to the National Association of State Budget Officers, state surpluses were 4.8% of expenditures in 1989. In 1991, these surpluses fell to a mere 2% of expenditures.

Additionally, the Center for the Study of the States reports that without tax increases enacted by state legislatures, state tax revenues would have fallen about 1.3%, or some 6%, when adjusted for inflation. "while state tax receipts are stagnating, spending requirements are not," the report warns. State governors have estimated that spending will increase 5.2%, and outlays for Medicaid and other programs could be considerably higher.

Also, Fiscal Year 1991 state budget shortfalls totalled $11.8 billion in the 30 states reporting shortfalls, and up to one-third of 450 Texas cities have experienced revenue shortfalls in the most recent fiscal year.

To cope with this situation, most state and local governments have moved increasingly to debt financing of infrastructure projects. In 1981, 37.5% of infrastructure investment was financed by the issuance of municipal bonds. By 1989, debt financing paid for 53.9% of infrastructure investment. And, this trend is likely to continue. But the rebate regulations make this trend more costly than it has to be.

THE TAX REFORM ACT OF 1986 MADE DEBT FINANCING MORE COSTLY

It's clear that Texas has urgent infrastructure needs which must be debt-financed. But the federal government has made this more difficult by imposing the arbitrage rebate regulations. These regulations have increased costs of debt financing because: (1) issuance costs increase as issuers sell bonds in smaller amounts more frequently to comply with spend-out schedules, (2) issuers must hire consultants and create new accounting systems to comply with the regulations, and (3) issuers avoid advance refunding high coupon pre-1986 debt to avoid subjecting the refunding bonds to rebate restrictions.

(1) Construction bond issuers must often split what could be one bond issue into two or more in order to insure proceeds will be spent in accordance with the two year spend-out schedule. They may also issue more frequently to comply with the requirement that no more than 25% of bond proceeds be spent on equipment. These additional bond sales increase costs of issuance.

For example, a state agency regularly finances the design and construction phases of projects separately in order to comply with the two-year spend-out schedule. This practice cost them approximately $80,000 in additional issuance costs during the last fiscal year.

A university will regularly issue notes for the construction of several projects at once. However, to comply with the requirement that no more than 25% of an issue be used to purchase equipment, they must often issue additional bonds, even when bond proceeds are on hand. These additional bonds are issued to handle equipment purchases which, if purchased from bond proceeds on hand, would take them over their 25% limit. This practice cost $50,000 over the last fiscal year.

(2) Because the regulations implementing the Tax Reform Act of 1986 are so complex and lengthy, issuers aren't able to comply without the assistance of financial advisors, bond counsel, and accounting firms. There are also significant costs to states and localities for the internal tracking systems which must be created and maintained for compliance.

The State Treasury, on behalf of two state bond issuers, is paying an outside consultant to calculate arbitrage rebate approximately $35,000 per year for 33 bond issues.

Another state agency paid $93,000 in one fiscal year to outside consultants to create a tracking system and perform the calculations. Their costs will likely be $20,000 per year for future annual calculations.

A Texas city is paying $29,000 per year for internal recordkeeping costs and calculation of rebate by outside consultants. Another city spends $10,000. per year for the man-hours needed to maintain the necessary internal records.

It's clear that the IRS $3,000 credit is not sufficient when calculation costs for a plain vanilla general obligation bond issue will range from $30,000-$90,000 over the life of the bonds. And these costs do not include the man-hours required to create and maintain the recordkeeping necessary to provide the data for the calculations.

(3) In some cases, issuers do not refund pre-1986 debt in order to avoid dealing with the arbitrage rebate regulations, though the issuer's current debt may bear interest at a rate which could exceed current rates by more than 3%. If arbitrage rebate were not a factor, the debt service savings resulting from the refunding could ease the burden on taxpayers.

For example, a Texas issuer sold over $300 million in bonds in 1983. The outstanding bonds carry coupons ranging from 10% to 10.75%. With current tax-exempt rates at 7%, the refunding of the outstanding debt could produce substantial savings. But due to the rules which would impact the refunding, the issuer cannot refund the outstanding issue because they cannot produce savings.

It's these expenses, in addition to the loss of investment earnings which must be rebated to the federal government, which make the financing process more difficult and costly. This makes it even more difficult for states and localities to provide needed infrastructure.

S. 913 WILL HELP DECREASE THESE COSTS

I'd like to speak specifically two provisions in S. 913 which will significantly reduce the costs to state and local governments while increasing revenues for the federal government.

The provisions I'm referring to are: permitting issuers to retain 10% of their arbitrage earnings; and, eliminating yield restrictions for issuers who plan to comply by rebating excess investment earnings.

By permitting issuers to retain 10% of arbitrage earnings, the federal government provides an incentive for issuers to earn as much investment income as they safely can, which will help offset the costs attributed to calculating arbitrage rebate and provide the federal government with additional rebate income. Because issuers are not currently permitted to retain rebate, there is no incentive to earn as much as possible on their investments. In fact, I've responded to a request by state and local governments to create a tax-exempt investment pool where they may invest tax-exempt bond proceeds in other tax-exempt securities. This tax-exempt fund will eliminate the participating issuers' need to calculate rebate and will eliminate any rebate they may have otherwise been required to pay to the federal government. In some cases, the pool participants may be choosing to risk earning negative arbitrage to avoid the cost of calculating rebate. Giving these issuers the incentive to earn arbitrage would certainly increase the dollars flowing to the federal government.

If yield restrictions are eliminated for issuers who wish to choose rebate as an option, the earnings which can flow to the issuers and to the federal government

will increase because earnings will be unrestricted. And, the costs of complying with yield restriction will be eliminated.

If this provision is coupled with allowing issuers to retain 10% of arbitrage earned, issuers will be less restricted in the arbitrage they may earn, and will have the incentive to earn as much as possible. This would provide federal, state, and local governments with sorely-needed funds.

PASS-THROUGH OF BANK DEDUCTIBILITY TO BOND POOLS

One provision which would also reduce costs and which I'd like to see included in S. 913 is pass-through of the small issuer bank deductibility to bond pools.

Texas is developing a school facilities program which would consolidate the issuance of school district debt through a state bond pool. Clearly, the state would be able to offer greater interest savings if small issuers could transfer their bank deductibility to the bond pool. Other states are also interested in this concept and would like to see it included in S. 913 (Alaska, Michigan, Maine, Vermont, New Hampshire, Indiana, Colorado). (See Exhibit I.)

SUMMARY

There is a great need for investment in infrastructure. It does not look like there will be current receipts or federal funds available for this investment any time in the near future. Therefore, debt financing will be utilized increasingly in the attempt to meet these needs.

However, in these recessionary times, by imposing federal mandates without funding them and reducing federal assistance, the federal government practically points states and local governments down the road of debt financing, and then throws up a roadblock the arbitrage rebate regulations.

While I support the federal government's desire to curb abusive tax-exempt issuance, I believe that goal can be reached further burdening issuers and in a way which will benefit the federal government. And S. 913 can accomplish these goals.

Thank you.

EXHIBIT I—THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

SUMMARY

The United States Senate Finance Committee and Mouse Committee on Ways and Means are considering comments and developing proposals on how federal tax code provisions can be simplified and made more efficient.

This proposal would amend the tax code to permit the limited pass-through of bank-qualified borrowing to small-issuer participants in a pooled issue.

The amendment would allow small issuers of bank-qualified bonds (also known as qualified tax-exempt obligations) to sell !heir bonds to a pooling issuer, or bond bank, which would then designate and issue an equivalent amount of pool securities as bank-qualified bonds and use the proceeds to buy the small issuers' bonds. Any small-issuer bonds purchased with the proceeds of the bank-qualified pool bonds could not subsequently be designated and sold in the marketplace as bank-qualified bonds.

This benefits both the small issuer and the U.S. Treasury. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from economies of participating in the pool. Fewer dollers spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service costs.

For the U.S. Treasury, fewer tax-exempt bonds would mean a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

HOW THE PASS-THROUGH WOULD WORK

CURRENT LAW: Banks may purchase qualified tax-exempt bonds and deduct 80 percent of the cost associated with the purchase and carry of such bonds. These bonds are sold by tax-exempt entities—the small issuers—who expect to borrow $10 million or less in a calendar year. Small issuers, who would issue bank-qualified bonds on their own, do not receive this benefit when they participate in a pooled issuance, unless the pool authority itself expects to issue less than $10 million a year.

The value of bank qualification varies over time; the interest rate on a bank-qualified security may be anywhere from 5 to 35 basis points lower than an identical bond that is not bank qualified, depending on credit market conditions and the demand of banks for tax-exempt securities.

THE REQUEST: To permit the limited pass-through of bank-qualified borrowing to small issuers participating in a pooled bond issuance.

THE BENEFITS: The addition of bank-qualified borrowing as a pass-through feature supports tax simplification and helps those small issuers targeted for assistance by the staff of the House Committee on Ways and Means—the "governmental units which are unduly burdened by the administrative complexity of rebate calculations . . . have difficulty accessing the national debt market at reasonable rates and must rely heavily upon local banks as purchasers of their obligations." [1]

The small issuer *and* the U.S. Treasury benefit from the pass-through. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from the economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service carrying costs.

For the U.S. Treasury, fewer tax-exempt bonds means a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

EXHIBIT II

The following national public interest groups, representing virtually all segments of state and local government, support S. 913:

Airport Operators Council International; American Association of Port Authorities; American Association of School Administrators; American Association of State Colleges and Universities; American Planning Association; American Public Gas Association; American Public Power Association; American Public Works Association; Association of Local Housing Finance Agencies; Association of Metropolitan Sewerage Agencies; Association of Metropolitan Water Agencies; Council of Infrastructure Financing Authorities; Government Finance Officers Association; International Bridge, Tunnel and Turnpike Association; International Institute of Municipal Clerks; Municipal Treasurers Association; National Association of Counties; National Association of Development Organizations; National Association of Elementary School Principals; National Association of State Auditors, Comptrollers & Treasurers; National Association of State Treasurers; National Conference of State Legislatures; National Council of Health Facilities Finance Authorities; National League of Cities; National School Boards Association; Public Housing Authorities Directors Association; U.S. Conference of Mayors; Water Pollution Control Federation

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PREPARED STATEMENT OF STEPHEN KAFOURY

I. INTRODUCTION

My name is Stephen Kafoury. I am pleased to be here today and I appreciate the opportunity to testify on legislation to simplify and improve provisions of the Internal Revenue Code governing the issuance and purchase of tax-exempt bonds issued by local public school districts.

I am an elected member of the Portland, Oregon Public School District No. 1, immediate past president of the Oregon School Boards Association, and currently serve on the National School Boards Association's (NSBA) Council of Urban Boards of Education Steering Committee. I am here today on behalf of NSBA, and the over 97,000 local school board members responsible for governing local public school districts across the nation.

II. OREGON LAW PRECLUDES ISSUES OF ARBITRAGE BONDS

I should like to begin by providing you with a brief overview of the law that applies to local public school district finance in my home state of Oregon.

Oregon school districts rely on real property taxes to fund the cost of providing a free, appropriate public education to our students. The annual operating budget of

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[1] Committee on Ways and Means—U.S. House of Representatives, "Written Proposals on Tax Simplification—Bond-related Proposals," Committee Print—101st Congress, 2nd Session, May 25, 1990, p. 60.

Oregon school districts is subject to a local property tax cap which will be substantially reduced over the next five years, despite the fact that we anticipate significant increases in enrollment, personnel and education programming. Facility construction and building improvements (as defined in the Oregon constitution) are not subject to this cap if the projects are financed by voter-approved general obligation bonds. Because that is so, Oregon school districts are effectively precluded, as a matter of law and fact, from issuing "arbitrage" bonds or using the proceeds of tax-exempt issuances (including arbitrage) to fund any project other than those which satisfy the "facility construction and improvement" definition contained in the Oregon constitution.

III. EDUCATIONAL BENEFITS OF S. 913, THE TAX-EXEMPT BOND SIMPLIFICATION ACT OF 1991

In Oregon, as in many other states across the nation, the cost of school district compliance with the current arbitrage rebate rules must come directly from funds which would otherwise be used to fund the many education and related services our students so desperately require. In that regard, we believe that the bill you consider today would go a long way toward assuring that the interests of students, school districts and the Federal Government are both furthered and preserved. This is so for several reasons.

A.Small Issue Rebate Exception: Removal of Disproportionate Regulatory Costs

First, increasing the small-issuer rebate exception from $5 million to $25 million will provide relief to the over 7,000 small school districts that are the least able to understand and pay the cost of compliance with over 234 pages of complex Treasury Department arbitrage rebate regulations and penalty requirements.

For example, this provision would have been a significant benefit to the Beaverton, Oregon School District which issued a bond in 1988 to finance the cost of facility construction and equipment acquisition. Properly sized at $13.8 million, the bonds were issued at the commencement of plan design for the facilities. Nevertheless, because bond proceeds were invested and paid out over the term of the construction contract, the district was required to pay rebate or invest in State and Local Government Series issues. The district elected to pay the rebate. As a result of this election, on March 14, 1991, the district had spent over 100 hours of management and 250 hours of clerical time on compliance activities, purchased computer software for $5,000, educated auditors on how they arrived at their rebate figures, and paid to the Federal Treasury a rebate in excess of $512,000.

Alternatively, enactment of this provision in 1991 would assure that at least a portion of the $250,000-$300,000 rebate the North Clackamas School District estimates it will be required to pay on a $22 million issue to fund the cost of constructing a new elementary school, completing construction of a junior high school, and making additions to several existing facilities will be available for construction maintenance and equipment upgrades.

B. Small-Issuer Bank Interest Deduction: Reduction of Loan Costs

Second, increasing the small-issuer bank interest deduction exception from $10 million to $25 million will simplify and reduce the cost of financing for small school district issuers by allowing them to borrow directly from their local bank rather than incurring the additional costs associated with borrowing from the bond market. In addition, NSBA believes that increasing this exception will have a positive political impact on local taxpayers who understandably would prefer that local tax dollars remain in their community supporting the local economy.

C. Retroactive Rebate Relief Provision: Fairness

Third, this legislation would make the rebate relief provision contained in the 1989 Omnibus Budget Reconciliation Act retroactive to bonds issued after August 31, 1986. NSBA believes that this provision is needed to assure that districts which issued bonds prior to enactment of the two year rebate exception are not penalized in their efforts to comply with rules Congress has expressly recognized as unworkable.

D. Five Percent Unrelated Use Provision: Unnecessary

Fourth, the bill would repeal the five percent disproportionate or unrelated use restriction. NSBA believes that, with respect to the facts that obtain in the local school districts setting, this rule serves no legitimate purpose. That is, although certain portions of a local public school may be available for pre-arranged use by the public-at-large (i.e., gymnasiums, tennis courts, theaters), state laws generally operate to preclude the private sector from owning an interest in school district property.

E. Ninety Percent Rebate Provision: Practicality for School Districts

Finally, the legislation would require that school district issuers pay only 90 percent, rather than 100 percent, of rebate. This provision is beneficial to all school district issuers, large and small. As the Committee is aware, it is exceedingly difficult (if not impossible) to accurately determine the rebate that will be due and owing at the termination of a project. This is particularly true when bond proceeds are being used to fund projects at a number of different sites. Because that is so, NSBA believes that it is important for the Congress to recognize and address the inequity, which flows from a rule, which requires district issuers to pay 100 percent of rebate by extending this ten percent "safe-harbor" to school district issuers.

IV. CONCLUSION

In conclusion, Mr. Chairman, NSBA urges this Subcommittee to support public education by amending the current arbitrage rebate requirements to simplify the administrative burdens and complexity imposed on local public school districts by the Tax Reform Act of 1986

We appreciate your interest in this matter which is of particular importance and concern to local public school districts. NSBA will be happy to assist you in any way you deem appropriate as you address this issue. On behalf of NSBA, thank you again for the opportunity to testify before the Subcommittee today.

PREPARED STATEMENT OF LOUIS H. KATZ

Thank you Mr. Chairman and members of the subcommittee. My name is Louis H. Katz, and I am vice president and treasurer at George Washington University here in Washington, D.C. I am here on behalf of the National Association of Independent Colleges and Universities, the American Council on Education, the Association of American Universities, and the National Association of State Universities and Land Grant Colleges. Thank you for the opportunity to appear before this distinguished panel this morning.

I come before you this morning to testify in support of legislation introduced by your colleague, Senator Daniel Patrick Moynihan, which would make two important changes in the tax code that are critical to the health and continued viability of colleges and universities across the nation. This legislation, S. 150, would modify the characterization under current law of bonds issued by private, nonprofit colleges and universities as "private activity" bonds. The legislation would restore the category of "exempt person" bonds which existed prior to 1986. This category would be comprised of qualified bonds issued by state and local governments, and qualified bonds issued by Internal Revenue Code (IRC) section 501(c)(3) organizations. The legislation would also remove the $150 million limit on the amount of non-hospital tax-exempt bonds that a nonprofit organization could have outstanding at any one time.

President Laney has properly addressed the disparity between public and independent higher education institutions that the 1986 Act caused. Before I turn my attention to the impact of the $150 million limit, I do, however, wish to add a few remarks on this subject.

The 1986 decision to recharacterize tax-exempt bonds issued by private nonprofit colleges and universities as "private activity" bonds has significant tax policy implications, and is deeply troubling. The congressional ambivalence about this modification was apparent when, in the conference report to the 1986 Act, the conferees wrote that they:

> "recognize that section 501(c)(3) organizations typically perform functions which governments would otherwise have to undertake. The use of the term private activity bond to classify the obligations of section 501(c)(3) organizations in the IRC in 1986 in no way connotes any absence of public purpose associated with their issuance."

Unfortunately, the classification of bonds issued by private colleges and universities as "private activity" bonds does connote a lack of public purpose for several reasons. This characterization draws a sharp and inappropriate distinction between private nonprofit colleges and universities and their public counterparts, and it equates bonds issued by colleges and universities with profit-making ventures. The equality between public and private higher education with regard to public-purpose mission requires equal access to tax-exempt financing.

In addition to the recharacterization of these bonds, the second significant feature of Senator Moynihan's legislation is the elimination of the $150 million limit on the amount of non-hospital tax-exempt bonds from which a 501(c)(3) organization may

benefit. This special limit, imposed by the 1986 Act, has precluded access to tax-exempt financing for a number of outstanding independent colleges and universities across the country. In addition, the $150 million limit addresses a congressional objective that was addressed and achieved by other tax rules contained in the 1986 Act.

The House version of the Tax Reform Act contained this $150 million limit as a "wealth test" on independent colleges and universities benefiting from tax-exempt bonds. The suggestion that independent colleges and universities be subject to a wealth test to prevent arbitraging likely arose from the historical practice of these institutions of maintaining endowments as a funding source to ensure their continued ability to operate. The earnings from an endowment are, in effect, substantially similar to the annual appropriations received by governmental colleges and universities. Nonetheless, the existence of endowments gave rise to the perception that private colleges and universities were involved in economic arbitrage.

This committee, when determining tax policy, has always attempted to treat similarly situated individuals or groups similarly. Unfortunately, this $150 million limit fails this test. It imposes different rules on independent colleges and universities than their public counterparts, despite the fact that both public and independent institutions have identical *public purpose* missions. The cap also imposes limitations on vastly different types of institutions, which were in all likelihood not intended when the rule was drafted. If the $150 million limit were enacted to serve as a wealth test, then it fails to meet its objective. Large institutions without similarly large endowments are restricted in their access to capital, all by virtue of the fact that they have significant facilities needs.

Perhaps even more disconcerting is the impact that this limit has had on smaller institutions. These institutions traditionally have not required a sufficient amount of capital to justify the significant costs of issuing their own tax-exempt bonds. However, in a number of states, these smaller institutions have been able to participate in pooled financings. In these types of arrangements, a larger institution serves as the primary issuer, and is able to absorb a significant share of the initial costs of issuing the obligation. These smaller institutions are then able to "pool" their limited resources with the resources of the larger institution and gain access to the tax-exempt bond market. The $150 million limit, since it precludes many of these larger institutions from entering the tax-exempt bond market, also precludes smaller colleges and universities from obtaining the benefit of tax-exempt financing which Congress has historically granted all 501(c)(3) organizations, regardless of size.

It is also important to recognize that other changes made by the 1986 Act have made the $150 million limit unnecessary. The 1986 Act included a number of modifications to tax-exempt bond rules for 501(c)(3) organizations, including arbitrage rebate requirements, as well as bond maturity, hedge bond, and advance refunding restrictions. These changes, as well as the Tax Equity and Fiscal Responsibility Act of 1982 public approval requirements, render the $150 million limit obsolete.

Mr. Chairman, members of the subcommittee, I urge you to give favorable consideration to Senator Moynihan's legislation, S. 150, which would restore the traditional parity in access to tax-exempt financing between public and independent colleges and universities. Thank you for the opportunity to appear before you this morning. I would be happy to answer any questions which you may have.

Prepared Statement of Representative Barbara B. Kennelly

Good morning. Thank you Senator Boren for this opportunity to appear before you this morning.

I too am here to lend my support for S. 284. Denis Mullane of Connecticut Mutual Life suggested this idea to me more than two years ago now. I introduced legislation to clarify the tax treatment of the prepayment of death benefits in the House and was pleased that Senators Bradley and Lieberman subsequently introduced Senate legislation.

I am pleased to say that my companion bill, H.R. 134 has 115 cosponsors in the House including 9 on the Ways and Means Committee. I am extremely hopeful about its chance for passage this year. On the House side, there are ongoing disctax treatment to those situations where payment is paid by an insurance company to the insured. This is to protect beneficiaries against some of the unscrupulous practices of some of the so-called living benefit companies, some of which pay out as little as 55% of face value. In addition, the cost of a prepayment me say at the outset that I believe these differences are relatively minor and would present no roadblock to enacting this legislation this year.

First and foremost, H.R. 134 would limit preferential tax treatment to those situations where payment is paid by an insurance company to the insured. This is to protect beneficiaries against some of the unscrupulous practices of some of the so-called living benefit companies, some of which pay out as little as 55% of face value. In addition, the cost of a prepayment option under a life insurance contracts would not be treated as a "qualified additional benefit."

Second, H.R. 134 legislation would provide favorable tax treatment only for benefits paid out after December 31, 1991. Further, in order to assure a referral solely to the Ways and Means Committee, H.R. 134 does not include the Medicaid clarification contained in S. 284.

Finally and perhaps most contentiously, H.R. 134 does not extend favorable tax treatment to permanent confinement to a nursing home. This reflects my concern that to do so would result in improper utilization of nursing home services and that of the staff on the Joint Committee on Taxation who expressed concern that such a provision is at odds with the definition of life insurance.

In summary, I believe we can enact improvements in our health care system this year despite the deficit and a pay-as-you-go budget. Access to these benefits on a tax-free basis can make the lives of the terminally ill significantly easier with very little cost to the federal government. I would urge the Committee's favorable consideration.

[SUBMITTED BY JOHNNY H. KILLIAN]

Congressional Research Service • The Library of Congress • Washington, D.C. 20540

June 11, 1991

TO	:	Senate Committee on Finance Attention: John Leggett
FROM	:	American Law Division
SUBJECT	:	Congressional Power to Proscribe Certain State Taxes

This memorandum is in response to your inquiry to consider whether Congress is empowered under the Constitution to enact legislation which would forbid the States, as certain of them do now, from imposing a tax upon the income of residents of other States derived from the pension system of the taxing State. At present, as we understand it, at least five States do expressly treat their income tax laws as applicable to the pension income of persons who have moved from the State and reside in another State. Pending before the Committee is S. 267, 102d Congress, which would proscribe the practice.

Under the supremacy clause of the Constitution, Art. VI, cl. 2, federal laws which are "made in Pursuance" of the Constitution are pronounced to be "the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." Under this clause, whenever Congress acts within one of its delegated powers, it may entirely displace state law on the same subject matter, whether state law be in conflict with the federal law, be complementary to it, or be in some other relationship to it. Of course, Congress need not pre-empt state law; it may leave it to coexist to the extent it does not conflict with the federal policy or interfere with the effectuation of the federal policy. The question is always one of congressional intent. "[W]e have consistently emphasized that the first and fundamental inquiry in any pre-emption analysis is whether Congress intended to displace state law . . . ." *Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 6 (1986). Only in the absence of declared congressional intent, either in statutory language or in the legislative history, does the Court enter into an examination of whether the two laws may coexist. *Louisiana Public Service Comm. v. FCC*, 476 U.S. 355, 368-369 (1986).

Here, where the intent is clear, we need concern ourselves only with two questions. Is there a delegated power under which Congress may act? If there is, may Congress displace a state taxing law in the exercise of the power?

Although there are numerous constitutional issues that are problematical, in the sense that it is possible to derive more than one defensible answer by a

reading of the constitutional provision, its structure and history, and the judicial precedents, these questions lend themselves to straightforward resolution. The commerce clause, Art. I, § 8, cl. 3, is the settled source of authority, and state tax laws enjoy no immunity that other state statutes do not have.

One of the predominant legislative powers delegated by the Constitution is the power to regulate commerce among the States. From the beginning, it has been understood that the authority at least comprehends the ability to regulate that which crosses an interstate boundary, even to the extent of prohibiting activities that cross state boundaries. *Champion v. Ames*, 188 U.S. 321 (1903). Interstate commerce is definitely involved in this tax situation. The pensioners have moved across a state line. The pension income moves across state lines, either through the mails or through some form of electronic transfer. The tax bills are mailed into other States, and efforts to collect the taxes claimed to be owed similarly utilize the mails or other forms of interstate instrumentalities. Congress may deny the use of the mails to further conduct it deems to be against public policy. *In re Rapier*, 143 U.S. 110 (1893). It regularly regulates other means of interstate communication.

Thus, the jurisdictional basis exists for legislation. We need not consider the doctrine that has developed as a potent engine of federal regulation, the theory of jurisdiction based upon the "effect" upon commerce of certain activities, even though, based on the amount of funds involved, legislative jurisdiction no doubt exists on that theory as well.

Once legislative jurisdiction is found, federal power to regulate is plenary, bounded only by the limitations the Constitution itself places on the power. While there has been controversy of late with respect to the extent of congressional power to regulate the States as States, there is none about the power to displace state law in its impact upon private conduct. *National League of Cities v. Usery*, 426 U.S. 833, 840 (1976), overruled on other grounds in *Garcia v. San Antonio Metropolitan Transit Auth.*, 469 U.S. 528 (1985).

> A wealth of precedent attests to congressional authority to displace or pre-empt state laws regulating private activity affecting interstate commerce when these laws conflict with federal law. . . . Moreover, it is clear that the Commerce Clause empowers Congress to prohibit all - and not just inconsistent - state regulation of such activities. . . . Although such congressional enactments obviously curtail or prohibit the States' prerogatives to make legislative choices respecting subjects the States may consider important, the Supremacy Clause permits no other result. *Hodel v. Virginia Surface Mining & Reclamation Assn.*, 452 U.S. 264, 290 (1981).

A substantial body of precedent establishes that state tax laws are not exempted from the breadth of this principle.

Illustrative of this point is *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979), a case so similar to the present controversy that it merits extended treatment. The case involved a conflict between New Mexico and Arizona. New Mexico imposed an energy tax on the privilege of generating electricity within the State. The utilities party to the case produced in New Mexico electricity which they sold almost exclusively to consumers in Arizona. Utilities selling their electricity within New Mexico paid a retail sales tax on that activity, and they could offset the sums paid under the generating tax with a credit for the sales tax. But the companies selling electricity in Arizona had no gross receipts tax liability against which to offset the generating tax liability.

While Arizona and the utilities were contesting the generating tax liability in New Mexico courts under a negative commerce challenge, the two Arizona Senators sought and obtained in Congress a measure which prohibited the New Mexico tax, only the New Mexico tax. Tax Reform Act of 1976, § 2121(a), 90 Stat. 1914, 15 U.S.C. § 391. The section provided:

> No State, or political subdivision thereof, may impose or assess a tax on or with respect to the generation or transmission of electricity which discriminates against out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity. For purposes of this section, a tax is discriminatory if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce.

The Finance Committee's explanation of the section follows:

> The committee has learned that one State places a discriminatory tax upon the production of electricity within its boundaries for consumption outside its boundaries. While the rate of the tax itself is identical for electricity that is ultimately consumed outside the State and electricity which is consumed inside the State, discrimination results because the State allows the amount of the tax to be credited against its gross receipts tax if the electricity is consumed within its boundaries. This credit normally benefits only domiciliaries of the taxing State since no credit is allowed for electricity produced within the State and consumed outside the State. As a result, the cost of electricity to nondomiciliaries is normally increased by the cost

> the producer of the electricity must bear in paying the tax. However, the cost to domiciliaries of the taxing State does not include the amount of the tax.
>
> The committee believes that this is an example of discriminatory State taxation which is properly within the ability of Congress to prohibit through its power to regulate interstate commerce. S. Rept. 94-938, pt. I, pp. 437-438 (1976).

Debate on the Senate floor, in which a motion to strike the provision was defeated, made clear the conflict was between the two States. 122 CONG. REC. 24324-24329 (1976).

Unanimously, in *Snead*, the Supreme Court sustained the federal statute to invalidate the New Mexico tax. Two important points were made.

First, New Mexico argued that the statute was only a restatement of the commerce clause limits on state taxation. Thus, under the precedents, New Mexico's total tax structure had to be assessed to determine if the State in fact did impose a greater tax burden on electricity sent out of State. The result of that examination revealed that utilities selling electricity within the State paid a total 4% tax, 2% from the electrical energy tax and 2% from the gross receipts tax, whereas sales out-of-state subjected a utility only to the 2% generation tax, leaving out-of-state distributors actually better off than in-state ones.

The Court rejected this attempt to conflate the commerce clause standard and the statutory standard. The former might well require a totality review, but the statute "is directed specifically at a state tax 'on or with respect to the generation or transmission of electricity,' not to the entire tax structure of the State." *Snead*, supra, 441 U.S., 149. So considered, the generating tax was discriminatory within the meaning of the federal statute. Id., 149-150.

Thus, Congress is not limited to legislating against state taxation or regulation that would be independently invalid under the negative commerce clause. It may proscribe state laws on its own views of policy, based on its own considered judgment of fairness and equity.

Second, New Mexico argued that if the federal law were construed in this fashion, it would be unconstitutional. Again, unanimously, the Court faulted this contention.

> In view of the broad power of Congress to regulate interstate commerce, this argument must be rejected. . . . Here, the Congress had a rational basis for finding that the New Mexico tax interfered with interstate commerce, and selected a reasonable method to eliminate that interference.

The legislation thus was within the constitutional power of Congress to enact. Id., 150.

Snead is not an isolated case. Following *Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines*, 405 U.S. 707 (1972), in which the Court ruled that neither the commerce clause nor federal law precluded state or local authorities from assessing head taxes on passengers boarding flights at state or local airports, Congress, after extensive hearings, included § 7(a) in the Airport Development Acceleration Act of 1973, 87 Stat. 90, 49 U.S.C. App. § 1513. That section expressly pre-empts state or local gross receipts taxes on the sale of air transportation or the carriage of persons traveling in air commerce. In *Aloha Airlines v. Director of Taxation of Hawaii*, 464 U.S. 7 (1983), the Court applied this provision to invalidate a state tax on the gross receipts of airlines selling air transportation and carrying persons traveling in air commerce. See also *Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986)(interpreting federal law, including § 7(a), as not precluding a state tax on all aviation fuel sold within the State to airlines regardless of whether the fuel was used to fly interstate or internationally).

Just as with airlines, Congress has legislated to proscribe what it deems to be discriminatory rail taxation by the States. Emerging after a long congressional debate over improving the condition of the Nation's railroads, the Railroad Revitalization and Regulatory Reform Act of 1976, *inter alia*, forbade a series of state taxes having a discriminatory impact upon the railroads, § 306, 90 Stat. 54, 49 U.S.C. § 11503, which has resulted in innumerable decisions in the federal and state courts and the invalidation of a variety of state tax laws. E.g., *Ogilvie v. State Bd. of Equalization*, 657 F.2d 204 (8th Cir.), *cert. den.*, 454 U.S. 1086 (1981); *Richmond, Fredericksburg & Potomac Railroad v. Virginia Dept. of Taxation*, 762 F.2d 375 (4th Cir. 1985); *Kansas City Southern Railway Co. v. McNamara*, 817 F.2d 368 (5th Cir. 1987); *Trailer Train Co. v. State Tax Comm.*, 929 F.2d 1300 (8th Cir. 1991). And see *Burlington Northern Railroad Co. v. Oklahoma Tax Comm.*, 481 U.S. 454 (1987)(§ 306 permits federal court review of railroad's claim of alleged overvaluation of its property).

Following the Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), in which it held that the net income from the interstate operations of a foreign corporation could be subjected to state taxation that was not discriminatory and was properly apportioned to local activities within the taxing State forming a sufficient nexus to support the tax, Congress, responding to the concerns of businesses that mere solicitation within a State would be sufficient to establish a tax nexus, and see *Scripto v. Carson*, 362 U.S. 207 (1960), enacted what was intended to be a temporary law. P. L. 86-272, 73 Stat. 555, 15 U.S.C. § 381. The statute provided that no State was to have power to impose a net income tax on income derived within the State from interstate commerce if the recipient of the income confined its business within the State to "the solicitation of orders . . . in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State." See *Heublein v. South Carolina Tax Comm.*, 409 U.S. 275

(1972)(interpreting statute to approve the particular tax structure in issue). Again, this statute has occasioned a great deal of litigation in applying it, with no hint of a constitutional problem. See Sweeney, *State Taxation of Interstate Commerce Under Public Law 86-272: "A Riddle Wrapped in an Enigma Inside a Mystery"*, 1984 B. Y. U. L. REV. 169.

Finally, in order not to prolong overly this memorandum, we consider one more case, a case that is so idiosyncratic as probably to be a sport in its precise approach but nonetheless in a line with the other cases discussed. In *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451 (1962), the issue before the Court was the validity of Texas taxes levied and collected on insurance covering the company's property in Texas. All transactions pertaining to the insurance took place outside Texas. The insurers were domiciled in London and were not licensed in Texas, did no business in Texas, and had no office or agents in Texas. The insurance was bought and issued in New York, and the premiums and claims were payable in New York. Under three older Supreme Court decisions, the taxes would have been invalid, but more recent decisions had undermined them. However, the Court held that the vitality of the actual decisions was irrelevant, since Congress had adopted their principle as a statutory bar to the questioned taxes.

When the Court in *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944), had reversed years of precedents and ruled that insurance transactions across state lines constituted interstate commerce, subjecting the business to congressional regulation, Congress responded by enacting the McCarran-Ferguson Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015, providing that the regulation and taxation of insurance should be left to the States. On its face, the statute did not speak to the issue in *Todd Shipyards*. But the legislative history of McCarran-Ferguson did speak to the issue. Id., 370 U.S., 455-456. Thus, the House Committee report stated:

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision in the *Southeastern Underwriters Association* case. Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as, for instance, in *Allgeyer v. Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co. v. Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co. v. Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident

> or domiciled therein covering risks within the State or to regulate such transactions in any way. H. Rept. 143, 79th Cong., 1st sess., p. 3 (1945).

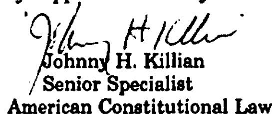
Senator McCarran read to the Senate this portion of the House report and stated that "we give to the States no more powers than those they previously had, and we take none from them." 91 CONG. REC. 1442 (1945).

On the basis of this evidence of congressional intent, not embodied in the statute, the Court held that it made no difference whether the three older cases remained valid. Congress "indicated without ambiguity that such state 'regulation or taxation' should be kept within the limits set by" the cases. Id., 370 U.S., 456.

Nor need we limit ourselves to congressional regulation of commerce in seeking examples in which state tax laws have been overridden. In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Court unanimously applied 4 U.S. C. § 111, which forbids the States to discriminate against federal officers or employees in taxing their pay or compensation, to strike down a state law that levied an income tax on retirement benefits paid by all employers, including the Federal Government, but that exempted retirement benefits paid by the State or its political subdivisions. Similarly, in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), the Court utilized 31 U.S.C. § 742, which barred discriminatory taxation of interest from certain obligations of the United States, to strike down a state law taxing the net earning of banks and expressly defining net earnings to include interest on obligations of the United States and its instrumentalities but to exclude interest earned on obligations of the State and its political subdivisions. See also *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983)(applying 31 U.S.C. § 742).

In conclusion, it may be said that Congress, under its commerce power, may legislate to modify or to displace state regulatory or taxing authority insofar as it applies to interstate commerce (and, of course, to the extent it has an impact on interstate commerce). In so acting, Congress need not merely supplement what the Constitution itself would prohibit or limit under the commerce clause, the due process clause, the privileges and immunities clause, and other constitutional provisions. It may enact its own policy notions and define in its discretion what constitutes interferences with interstate commerce.

The precedents reviewed thus uniformly support the validity of S. 267.



Johnny H. Killian
Senior Specialist
American Constitutional Law

Congressional Research Service • The Library of Congress • Washington, D.C. 20540

June 11, 1991

TO : Senate Finance Committee
Attention: John Leggett

FROM : American Law Division

SUBJECT : Validity of State Taxation of Nonresidents on Income Earned or Obtained Within the State

This memorandum is in response to your further inquiry relating to S. 267, pending before the Committee. The bill would prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of the taxing State. Our previous memorandum addressed the issue of congressional power to enact S. 267.

A separate issue, however, is whether, in the absence of federal legislation, a state tax on the pension income of nonresidents would be valid under the Constitution, perhaps the due process clause of the 14th Amendment or the privileges and immunities clause of Art. IV, § 2, cl. 1.

Little doubt exists that the States have the power to tax the income, from whatever source derived, of nonresidents, so long as the source of the income is within the taxing State. In *Shaffer v. Carter*, 252 U.S. 37 (1920), a resident of Illinois who derived income from oil and gas leases and from oil producing land in Oklahoma, challenged the application to him of the Oklahoma income tax law to the extent of the income derived from the Oklahoma sources. The Court sustained the power of Oklahoma to impose the tax.

> [W]e deem it clear, upon principle as well as authority, that just as a State may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to non-residents from their property or business within the State, or their occupations carried on therein; enforcing payment so far as it can, by the exercise of a just control over persons and property within its borders. Id., 52.

Decided the same day, *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920), upheld a similar tax imposed by New York on residents of Connecticut

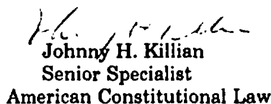
and New Jersey upon income earned in New York, id., 75, but the Court did hold unconstitutional a provision of the New York law that denied to nonresident taxpayers the personal exemption granted resident taxpayers. Id., 77-82 (privileges and immunities clause violated by the provision).

Reaffirming the approach of these two cases, the Court in *Austin v. New Hampshire*, 420 U.S. 656 (1975), found the privileges and immunities clause violated by the operation of a state income tax law which caused the tax to fall exclusively upon nonresidents and which totally exempted residents. In no way did the Court indicate any doubt about the continuing vitality of the two 1920s cases. And see Hellerstein, *Some Reflections on the State Taxation of a Nonresident's Personal Income*, 72 MICH. L. REV. 1309, 1310, 1341-1354 (1974).

In the presence of firm precedent for the proposition that a State may use its control over the source of the income of a nonresident as the basis for the imposition of an income tax as to that income, the only other premise for a constitutional attack would be to allege a due process violation arising from double taxation, should that occur, inasmuch as the State of residence could impose a tax on all personal income of a resident wherever earned. *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937); *Lawrence v. State Tax Comm.*, 286 U.S. 276 (1932); *Maguire v. Trefry*, 253 U.S. 12 (1920). In practice, of course, the prospect of double taxation has been mitigated or eliminated by the utilization of credits for taxes paid elsewhere. Hellerstein, op. cit., 1311. But, in any event, the Court long ago renounced the prospect of using the due process clause as a bar to double taxation. *Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 23 (1938); *Curry v. McCanless*, 307 U.S. 357, 372-374 (1937).

No reason appears to present itself why state income taxation of pension and retirement income should lead to a different result than that reached with respect to more direct earned income in *Shaffer v. Carter*. The States imposing such a tax take the position that pension and retirement income are but deferred payments for past years of service rendered to the employer, requiring no different treatment of this income, and in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 808 (1989), the Court adopted that precise characterization with respect to the pension benefits of retired federal officers and employees.

In conclusion, it appears to be settled that the state tax laws being considered would be sustained against federal constitutional challenge.



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PREPARED STATEMENT OF JAMES T. LANEY

Good morning, Mr. Chairman, members of the subcommittee. My name is James T. Laney, and I am president of Emory University in Atlanta, Georgia. Thank you for the opportunity to testify today in support of S. 150, introduced by Senator Daniel Patrick Moynihan earlier this year, and cosponsored by Senators Boren, Danforth, Pryor, Symms, and others. This legislation would undo several changes made to our tax laws affecting colleges and universities *which never should have been made.*

I am speaking on behalf of the National Association of Independent Colleges and Universities as well as the American Council on Education, the Association of American Universities, and the National Association of State Universities and Land-Grant Colleges. These organizations represent a diverse group of institutions of higher education, ranging from small liberal arts colleges to research universities. All of these institutions are deeply concerned about the ability of colleges and universities to utilize tax-exempt financing to carry out their educational mission.

Tax-exempt bonds are utilized by hundreds of colleges and universities, both public and private, for a wide variety of purposes including: construction and renovation of facilities such as libraries, academic buildings, and dormitories; major equipment purchases for modernization and research; and public safety projects, such as renovation of electrical and fire detection and prevention systems, as well as modifications to provide access to the handicapped.

At Emory University, we used tax-exempt financing prior to 1986 to finance $250 million of facilities, including research facilities where federally-funded research is being conducted, student dormitories, hospital facilities, classrooms, and other academic facilities. Because of the $150 million cap imposed on independent institutions in 1986, Emory is one of the institutions no longer able to use tax-exempt borrowing as a method of financing university facilities. Out of necessity, we have begun the process of funding urgently needed facilities through taxable borrowing. Borrowing in the taxable market will needlessly increase the university's financial costs. The result will be higher costs to university students and their families. You are aware that there are two areas where there is tremendous national pressure to hold down rate increases. How did we get into this bind?

The 1986 Tax Reform Act saw the rules governing tax-exempt bonds revised—and new restrictions enacted—to a degree never before or since contemplated. You will be hearing testimony today from others who will discuss the impact of a number of these restrictions in more detail. I would, however, like to use this opportunity to discuss what I believe are the harmful effects of two changes made by the 1986 Act that specifically target independent colleges and universities: (1) the characterization of bonds for these institutions as "private activity" bonds; and (2) the $150 million per institution limit on non-hospital qualified 501(c)(3) bonds. In both cases, I respectfully urge the subcommittee to reverse these two decisions because they seriously erode the ability of independent institutions to address pressing capital requirements.

1. CLASSIFICATION AS PRIVATE ACTIVITY BONDS

From enactment of the income tax until 1986, bonds for nonprofit organizations described in section 501(c)(3) of the Internal Revenue Code generally were treated the same as bonds used directly by states and local governments. In tax-exempt bond parlance, governments and section 501(c)(3) organizations were classified as "exempt persons." The 1986 Act redrew the line between section 501(c)(3) organizations and private businesses that receive tax-exempt financing for property used in their profit-making activities. Section 501(c)(3) organizations are now treated the same as profit-making ventures, *i.e.*, like private businesses.

As a matter of principal—not of finance—all of the institutions on whose behalf I am appearing today strongly object to this categorization. These institutions are private in their lack of direct governmental operation and funding, but they are not private businesses. Tax-exempt bonds provide funds to our nonprofit colleges and universities for the execution of clear and essential public purposes. Colleges and universities utilize tax-exempt bonds for the traditional kinds of public purposes which the Internal Revenue Code requires as & precondition to tax-exempt status under section 501(c)(3). In fact, one rationale for tax-exempt status of nonprofit institutions is that they serve purposes and carry burdens that governments would otherwise bear.

2. $150 MILLION LIMIT

The second point I will address is a direct financial restriction on independent colleges and universities imposed by the 1986 Act—the $150 million per institution limit on non-hospital qualified 501(c)(3) bonds. The $150 million limit effectively precludes approximately two dozen independent institutions from benefiting from new tax-exempt bonds. Thus, a growing number of universities may no longer use tax-exempt bonds to finance their capital projects—classrooms, libraries, research laboratories, and dormitories. The currently restricted institutions precluded from any tax-exempt borrowing represent 20 percent of the independent doctorate-granting universities in this country and their number will grow larger over time. They are, I would respectfully point out, among the institutions that undergird this nation's basic research capability.

I urge the subcommittee and Congress to repeal the $150 million limit for two reasons. The first is the compelling facilities needs of independent colleges and universities for new and renovated facilities if we are to meet the demands of the 1990s and the next century. A recent report by the National Science Foundation maintains that colleges and universities are having to defer $3.60 of needed repair and renovation work for every $1 spent on such work. Off all capital expenditures undertaken by independent colleges and universities, repair and renovation work is most dependent on debt financing.

The second reason I urge repeal of the $150 million limit is that it unfairly singles out independent colleges and universities and is premised on a misunderstanding of the role of these institutions. Until 1986, 501(c)(3) organizations were granted access to tax-free bond financing in recognition of the core public services they perform. Independent colleges and universities serve identical functions and provide similar services as the governmentally-funded institutions of higher education.

It is important to recognize that other changes made by the 1986 Act make the $150 million limit unnecessary. The 1986 Act included a number of modifications to the tax-exempt bond rules for 501(c)(3) organizations, including arbitrage rebate requirements, as well as bond maturity, hedge bond, and advance refunding restrictions. These changes, as well as the public approval requirements enacted in the Tax Equity and Fiscal Responsibility Act of 1982, render the $150 million limit obsolete.

Determining eligibility for tax-exempt financing by the amount of debt outstanding or by the size of the institution's endowment represents a misunderstanding of the institutions involved and the use of their endowment assets. The amount of debt outstanding for each of these institutions is a direct result of the size and complexity of the institution. The endowments of independent colleges and universities provide a financial base for long-term operation—a base not unlike the annual appropriations received by their state and local counterparts. More than 65 percent of college and university endowment funds are restricted by donors as to how the income derived therefrom may be spent.

To give you an example from my own institution, Emory's endowment currently produces approximately only 8 percent of our current operating budget, or a total of $56 million of annual income, which is fully committed to current requirements: $9 million to student scholarships; $12 million to servicing capital debt obligations; and $35 million to academic programs, leaving nothing available to the institution to fund future capital requirements. I have not polled the other institutions above the $150 million ceiling. However, I believe I can safely predict that none of the institutions have significant, uncommitted endowment resources, making it almost a necessity that they rely on higher cost taxable financing to meet future capital requirements. I believe I can also safely predict that all the institutions have substantial additional capital needs that must somehow be met if they are to continue to be a major part of the educational and research enterprise of the nation.

Mr. Chairman, members of the subcommittee, the colleges and universities of this nation provide one of the chief means by which this nation has prospered. We attempt to offer the highest quality of education possible. If we are unable to provide adequate facilities and financing of higher education, we cannot maintain that level of excellence. If public and private institutions are treated differently for purposes of tax policy, we cannot maintain the healthy atmosphere of competition between and among institutions.

I urge you to approve the legislation offered by Senator Moynihan and cosponsored by Senators Boren, Danforth, Pryor, Symms, and others which recognizes and reaffirms Congress' commitment to higher education. I thank you for allowing me to

appear before this distinguished subcommittee and would be happy to answer any questions you may have.

PREPARED STATEMENT OF SENATOR JOSEPH I. LIEBERMAN

Mr. Chairman and members of the Subcommittee, I want to thank you for the opportunity to appear before you today to talk about the Living Benefits Act, S. 284, that would provide for prepayment of death benefits to people who are terminally ill. This legislation amends section 101 of the IRS Code to exclude accelerated death benefits from income if paid to an insured person who is certified by a licensed physician as being terminally ill and expected to die within 12 months. In addition, the bill amends the Social Security Act to ensure that policyholders are not compelled to elect prepayment of death benefits, in order to become eligible or remain eligible for federal means-tested programs. I am pleased to be working with Senator Bradley of this Committee on this legislation, along with my Connecticut colleagues, Senator Chris Dodd and Congresswoman Barbara Kennelly.

When individuals suffer from cancer, AIDS or other life-threatening diseases, they are forced not only to confront the tragedy of their illness, but also the overwhelming economic consequences of their condition. Some of these people are in the prime of their lives and the principal financial supporters of their families. If they lose their jobs or are too ill to work, their families are unable to meet everyday expenses to cover the costs of housing, food and other necessities, and often they do not have the resources to obtain needed medical care. Too many people who find themselves seriously ill soon find themselves destitute as well.

Yet, for many of these people, thousands of dollars that they have saved carefully over the years lie just beyond their grasp—in the form of life insurance policies. Many Americans make life insurance their primary form of savings. In 1989, the American Council of Life Insurance found that 104 million Americans were covered by $5 trillion in individual life insurance and 138 million people had $3.4 trillion through group policies. The average American household has $87,600 in life insurance. This is money which could ensure a terminally ill person access to needed medical care, or could make the difference between keeping their home or becoming homeless. Our legislation would allow those who have a year or less left to live to opt for prepayment of death benefits, thus providing them with funds to pay for the enormous expenses associated with a terminal illness. Our bill gives certain seriously ill people a chance to live the remaining months of their lives as normally and comfortably as possible—by allowing them the opportunity to choose between receiving health care in a hospital, in a hospice, or in their own home; by giving them access to the medical equipment they need; or even by making it possible for them to take one last trip to visit a close friend or relative.

Prepayment of death benefits would provide a unique opportunity to channel a significant pool of existing financial resources to those in desperate need, with virtually no cost to the federal government. In fact, the legislation may save revenue if one considers that the money will enter the economy sooner because of the accelerated payment, and the influx of money may help many people avoid having to receive special government aid, such as Medicaid, welfare, or food for the poverty-stricken.

Terminal illnesses strike people from all segments of the population—the elderly, the middle-aged, young adults, and even children. Our bill would give such people economic flexibility—it would give them wider options on how to take care of their special needs as they approach the end of their lives. For example, one resident of Florida—where prepayment of death benefits is allowed—who lived alone in a trailer and whose only source of income was from Social Security, received an accelerated payment on her life insurance so that she could finance a last visit to her sister in Maryland, and to purchase a powered wheel chair so that she could be mobile.

Along with Florida, 48 other states have approved the sale of accelerated death benefit policies, and many insurance companies are now offering prepayment of death benefits if the person insured under the policy becomes terminally ill. But a gray area remains, and that has to do with tax treatment of such benefits. Under current law, death benefits paid to survivors of the life insurance policy are not taxed. But how accelerated benefits paid to the policyholder who has a year or less to live are to be treated is unclear under current tax law. Our legislation will ensure that all those who receive accelerated benefits will not have to pay taxes on them. Furthermore, the living benefits we provide for in our bill would give eligible policyholders the full value of their policies, instead of the lesser amounts they would receive if they were forced to turn in the policies for their cash values.

Both Prudential Insurance Company and Connecticut Mutual are to be commended for taking the lead in the insurance industry in proposing and crafting policies that would allow the terminally ill access to these benefits. I am proud to be working with Senator Bradley and the other 51 cosponsors on this legislation and I look forward to enacting this legislation so that those who qualify can benefit from this provision as soon as possible.

Prepared Statement of Shepard McKenney

My name is Shepard McKenney and I am one of the owners of the Hinckley Company, a yacht building firm located in Southwest Harbor, Maine. We are the oldest builder of production sailing yachts in the United States. We are one of approximately 800 small businesses in Maine associated with recreational boating which in total employs about 4,000 people. Maine is a center of traditional boat building and most of its boat yards are relatively small, employing less than 25 people. Ours is among the largest, employing, up until recently 160 people. We build boats from 40 to 60 feet at prices that run from $400,000 to $1,500,000.

The recession which began two years ago, and which has been especially severe in the Northeast has had a damaging effect on our industry and our area. Eastern Maine in recent years has had high unemployment and up until recently yacht building has provided one of the few opportunities for year round employment.

At The Hinckley Company we have attempted to fight the recession by an aggressive cost cutting program including eliminating all capital spending and a wage freeze for all employees. As a result of these and other steps we have, up until this year, been able to maintain reasonable full employment. A key element in holding our company together during this difficult period has been that we have aggressively marketed our products in foreign countries and the fact that a quarter of our production in the last two years has been exported to Japan, one of the most quality conscious markets in the world.

However, we can not survive without selling the majority of our production in the United States. Since the imposition of the luxury tax on January 1, 1991 we have sold 3 boats—this during a period when we would expect to sell 6 to 8 boats. One went to a customer in Switzerland (where the tax did not apply), and two to domestic customers. In the case of the domestic sales, we are finding that, to have any possibility of making the sale, we must agree to absorb the luxury tax in some fashion or other. Let me put this into context. Despite the fact that our boats are among the most expensive in the world for their size, our average profit margin over the last three years in boat building has been approximately 5%. I think you can see the affect of absorbing a 10% luxury tax. In other words, to a great extent the luxury tax that is being paid is being paid by us and not by our customers.

The fact is that, with rare exceptions, people aren't willing to pay the luxury tax. It is not, in most cases,that the prospective buyers are not able to pay the tax—they just won't. No one wants to pay a tax, and if the tax is avoidable people will avoid it. It is a simple matter for individuals with large disposable incomes to indulge themselves in other ways—be it golf condos on Hilton Head, foreign travel or race horses—these are not subject to the luxury tax. The wealthy not only have lots of money, they have lots of choices and they are choosing not to buy boats.

Because yachts are not being ordered we, and many other builders of yachts have had to take drastic steps. Earlier this year we laid off 10% of our work force and cut the pay of our remaining work force by 10% across the board. Let me give you some specific examples of the impact of these cutbacks.

Bill Carver, 61, has worked for the Hinckley Company for 26 years and he is one of 15 employees we have lad off since the beginning of the year. Bill works as a rigger, and we simply don't have enough work for him anymore. Because Bill's work is so peculiar to the boat building business, he will have a hard time finding other work. At the moment he is on unemployment as are many of those we've been forced to lay off. In fact, of the 15 people laid off only 7 have been able to find other work.

Mike LePlante, 31, an apprentice carpenter, was not laid off, but like our 130 remaining employees he did have his pay cut by 10% in February. Mike, who has three children, was already struggling to pay his rent, but was willing to accept minimal income to pursue his dream of being a boat builder. Mike showed great promise of being capable of the kind of craftsmanship required in doing the interiors of one of our yachts. With the pay cut, Mike couldn't afford to support his family and has moved with his family to Connecticut to live with his mother in law. Mike is one of 7 employees who have left the company as a result of the pay cut,

including Kay Stein, 31, who could no longer afford day care for her 5 year old daughter, Haley, and her 3 year old son Evan.

Norman Shaw is an electrician with the Hinckley Company where he continues to be employed. Norman gave up a higher paying job in the computer industry in Massachusetts to come to Maine to build boats. As is the case with many people at the Hinckley Company, Norm has been willing to accept a lower pay to work in the boating industry because of his love of craftsmanship and boats. With a 10% pay cut and no cost of living increase since 1989, Norm says he doesn't know how much longer he can wait before he moves out of the area and out of boatbuilding. The taxes on Norman's house have gone from $800 per year to $2,500 per year in the last three years and his wife is facing the prospect of being laid off from her work at the local hospital. In the meantime, Norm is giving up his luxuries, and is selling his 22 foot sail boat which has been his principal source of recreation.

While all of these situations concern us, what concerns us more is that the immediate future looks grim. For the first time in memory we do not have a single strong prospective customer for a new boat. If something doesn't happen soon, all of our employees will be looking for work.

Nor are we alone. Lee Wilbur, a powerboat builder who is a neighbor in Southwest Harbor has gone from 40 employees a year ago to 11 employees today and has not gotten a single new boat order since the imposition of the luxury tax.

Duffy and Duffy, a powerboat builder in nearby Brooklin, Maine has gone from 48 employees, a year and a half ago, to 22 employees today and has received no new boat orders since the imposition of the luxury tax.

North End Marine in nearby Rockland has gone from a staff of 105 in November 1990 to 60 on June 1, 1991.

With job loss so high and boats sales so low, I think it is safe to say that unemployment benefits paid will far exceed any luxury tax collected—and this does not account for the loss of income taxes, sales taxes and other economic spinoff from the industry—must less the loss in human terms.

It may seem that fancy yachts are only an indulgence for the rich. But in reality, these boats are the livelihood and love of many talented and dedicated working people who have devoted thee lives to building and maintaining these craft. Yachts are, in fact, a great redistributor of wealth. The building of them requires enormous amounts of labor. The average number of worker hours in one of our boats is approximately 10,000 or five man years. The materials and products we incorporate into our boats are 90% domestically produced where they provide substantial employment. Yachts require a great deal of maintenance. We estimate that between 5% and 10% of the purchase price of one of our boats is required for maintenance and upkeep annually. This maintenance and upkeep provides substantial employment for people in the boating industry.

On the Main coast I believe we build some of the most beautiful yachts in the world, employing the highest levels of craftsmanship. We take great pride in what we do and I hope the owners of our boats will forgive me when I say that I believe that we own these boats as much as they do. I might go further and say that they can do without these boats—but we can't.

At a time when there is much talk about the level of quality in American products and our ability to compete abroad is questioned we believe we are an industry that should be encouraged, not punished. At the Hinckley Company our principal competitors now are foreign—in Finland where yacht building companies are directly subsidized by the government and in Taiwan, where the effective labor rate is less than half of ours. We are confident in our ability to compete in national and international markets despite adverse competitive circumstances such as those illustrated by Finland and Taiwan. For that matter, we welcome the challenge of the ups and downs of a free economy, including the recession. We ask for no help from our government.

What is hard for us to understand is why the government in Washington would institute a policy that seems designed to single out our already depressed industry for extinction—and for no good purpose.

Prepared Statement of Daniel A. Mica

Good Morning Mr. Chairman and Members of the Subcommittee.

My name is Dan Mica and I am Executive Vice President—Federal Affairs of the American Council of Life Insurance. I am accompanied today by Stephen Kraus, Chief Counsel, Pensions at the ACLI.

I am pleased to testify today on behalf of the American Council of Life Insurance, which represents 616 life insurance companies, holding nearly 94 percent of the life insurance in force in the United States, and the Health Insurance Association of America, which represents 300 private health insurance companies providing health insurance for 95 million Americans. We are pleased to express our support for S. 284, the bill introduced by Senator Bradley which would treat accelerated death benefits on account of terminal illness as a non-taxable death benefit.

GENERAL COMMENTS

As a result of recent activity by some of the nation's largest insurers who are offering terminal illness accelerated death benefits to existing policyholders, more than 4 million individuals are now eligible for this benefit. Therefore, it is important that the Congress act quickly on this issue.

While we believe Senator Bradley's bill is an important step in the right direction, we think Congress needs to go further in two other areas.

First, Congress needs to clarify the tax treatment of death benefits which may be accelerated under conditions other than terminal illness.

Second, Congress should clarify that long-term care insurance be treated like health insurance.

Taken together, this three-pronged approach will help to address an important aspect of the health care crisis facing this nation.

We are all concerned with the escalating costs associated with terminal or catastrophic illness and the need for long-term care. We believe there is an important role for the private sector to play in providing individuals with protection against the devastating financial impact these costs can have on individuals and their families. The life and health insurance industry has developed innovative and cost effective insurance products to meet these needs.

Unfortunately, the ambiguities in the tax treatment of these products is discouraging the public from purchasing them. The tax laws need to be clarified to foster the development and growth of these very popular products.

ACCELERATED DEATH BENEFITS

The 1980s saw the evolution of a new generation of products by the life insurance industry. Called accelerated death benefits or "living benefits," these products allow policyholders access to the face amount of their policies prior to death in response to the growing need for more comprehensive health care coverage. This cost-effective approach uses a life insurance policy as the foundation to provide benefits under certain circumstances, such as:

- terminal illness—a medical condition which results in a drastically limited lifespan, usually twelve months or less.
- long-term care—personal care, health and social services needed by individuals who experience a chronic illness or disability.
- catastrophic illness—a medical condition which would, in the absence of extensive or extraordinary medical treatment, result in a drastically limited lifespan.
- permanent confinement to a nursing home—an illness or physical condition which can reasonably be expected to result in an individual remaining in a nursing home for the rest of his or her life.

Providing these coverages under a life insurance policy eliminates the administrative cost of separate contracts, enables a company to coordinate design of contract benefits to prevent coverage overlap, and ensures against lapse of coverage by permitting policy loans to pay premiums not otherwise paid by the policyholder when due. More importantly, however, is the cost savings inherent in utilizing the value of the death benefit and cash value of the underlying life insurance policy to provide these valuable benefits.

A terminal or catastrophic illness accelerated death benefit typically pays a certain percent of a policy's death benefit in a lump sum. Most policies currently being sold limit the proportion of the face amount which can be accelerated. The portion of the death benefit which is not accelerated is paid to the beneficiary upon the death of the insured.

A long-term care accelerated death benefit usually provides for the payment of a certain percent of a policy's death benefit each month the insured requires long term care. Such payment reduces both the policy's cash value and death benefit in a pre-determined amount. Under another policy design, the policyholder has the

option of receiving a lower payment based only on the excess of the death benefit over the cash value of the policy. Under this option, only the death benefit decreases each month by the amount paid.

The following example of a particular long-term care accelerated death benefit might be helpful.

Assume long-term care payments begin under a policy purchased by an individual with a $100,000 death benefit and a $10,000 cash value. The first monthly payment equals $2,000—that is, 2% of the death benefit. Both the death benefit and the cash value would be reduced by 2% so that after the first payment the death benefit and cash value will be $98,000 and $9,800 respectively. Under this particular policy, the policyholder has the option of keeping the cash value intact by choosing to receive a lower payment of $1,800, resulting in reduction of only the death benefit to $98,200 and leaving the cash value at $10,000.

There is substantial public support for these accelerated death benefit products. Almost 3/4 of those interviewed by the Roper Organization in May 1990 for an ACLI-sponsored study approved of the concept of accelerated death benefits. In addition, over 60% holding individually purchased life insurance policies indicated interest in being able to accelerate the benefits of their own policies.

In response to the growing public awareness of this need, the number of companies offering such products has increased rapidly. As of October 1990, the ACLI identified a total of 70 companies having some type of accelerated death benefit product. Preliminary results from our latest survey show that more than 100 companies are now offering some variation of this product. While most of the products currently available are offered with individual permanent life insurance policies, these benefits are also available with either individual or group term life insurance policies.

LONG-TERM CARE INSURANCE CONTRACTS

Also since the mid-1980s, the number of companies developing long-term care insurance products and the variety of products being developed has grown dramatically. Today, more than 115 life and health insurance companies are offering long-term care insurance protection and almost 2 million individuals have purchased long-term care policies.

Long-term care includes a wide range of medical and support services for people who suffer physical or mental disorders causing functional limitation or disability and who therefore need assistance for an extended period. The responsibility for providing long-term care assistance ranges from the individual and family to the government through the Medicaid program for those unable to provide for themselves. Stimulating the development of the private market for those who can afford coverage make it possible for the Federal government to target its direct long-term care assistance to those who are in greatest financial need.

Initially, long-term care policies were only marketed on an individually-purchased basis, but now are increasingly being offered through employer-sponsored programs. Both individually purchased and employer-provided long-term care policies currently being marketed by our industry have a level, individually determined premium which is guaranteed renewable. The insurer may not cancel the policy (except for non-payment of the premium) and the individual's premium will not increase regardless of his age or physical condition. Under an employer-based program, if the employer terminates sponsorship or the individual leaves the group covered by the policy, the insurer guarantees that each individual will have the right to continue the coverage provided under the policy at the same premium.

NEEDED CHANGES IN THE TAX LAWS

In order to make these products available and more affordable to consumers and to enable insurers to market these products successfully, the insurance industry believes that several clarifications and changes are needed in the current tax law as respects both accelerated death benefit policies and long-term care policies:

(1) *Accelerated death benefits.* Accelerated death benefits paid under life insurance policies should be treated like death benefits and thus, excludable from the income of the policyholder.

(2) *Definition of life insurance.* It should be made clear that the presence of an accelerated death benefit does not alter the status of the basic policy as one of life insurance for purposes of the tax law. Also, policyholders should be allowed to prefund the accelerated death benefits (e.g. by paying the premiums on a level basis).

(3) *Long-term care benefits.* Long-term care benefits paid under health insurance policies should be treated like health insurance benefits and thus, excludable from the income of the policyholder.

(4) *Premiums for long-term care benefits.* Amounts paid to an individual by reason of coverage under a long-term care policy should constitute payment for expenses incurred for medical care and therefore any premium for such coverage should be deductible just as premiums for other policies covering medical expenses are deductible.

(5) *Inclusion of long-term care in a cafeteria plan.* Coverage under a long-term care insurance policy should be allowed as a benefit under the cafeteria plan provisions, thereby allowing employees to elect such coverage to be paid from the available pool of dollars.

(6) *Treatment of long-term care contributions under certain employer programs.* Contributions made by an employer on behalf of its employees for benefits under a long-term care insurance policy should not be includable in the employees' income and should be currently deductible by the employer.

CURRENT LEGISLATION

We are pleased that several bills have been introduced that favorably deal with one or more of the issues outlined above. Earlier in this statement, we expressed our support for S. 284, which would treat accelerated death benefits on account of terminal illness as a non-taxable death benefit. The most thorough treatment of these tax issues, supported by the ACLI and HIAA, is contained in S. 1021, a bill introduced by Senator McCain, and H.R. 1693, introduced in the House by Congressman Gradison. We strongly support the efforts of Senators Bradley, McCain and others who have introduced legislation to clarify and modify the tax law as it applies to accelerated death benefit products and long-term care insurance.

CONCLUSION

The potential devastating cost of terminal or catastrophic illness and long-term care is a critical issue that must be addressed. The life and health insurance business can meet a significant part of the challenge in an efficient and cost-effective manner. Congress, for its part, can help by providing favorable clarification of the current tax law with respect to accelerated death benefit and long-term care products. This will go a long way towards addressing this problem and encouraging insurers to develop an extensive, private insurance market. Moreover, such action will encourage those individuals who can afford to protect themselves to do so, and encourage purchase of insurance at younger ages when the price is more affordable. In addition, such action will stimulate employers to provide coverage to their employees where the potential for reaching the most people is greatest.

Thank you, Mr. Chairman, for the opportunity to present our views. We look forward to working with you and your colleagues to develop legislation that will effectively deal with the critical health issues facing this nation.

PREPARED STATEMENT OF SENATOR BARBARA A. MIKULSKI

Mr. Chairman, when the luxury tax on boats was put into the 1990 Budget Reconciliation bill, I was on the Senate floor telling this Congress that "we have to go get it from those who got it." I meant that. America needs a tax system that makes people pay their fair share. Those who are benefiting most from this country's success have a responsibility to give something back.

But America doesn't need a tax system that puts people out of work. That's just what the luxury tax on boats is doing. We thought we were going after the Donald Trumps and the Leona Helmsleys when we put this tax into the budget package. It turns out that we're just hurting the Mom and Pop small businesses in Maryland and across the country. These are the people who build the boats, insure the boats sell the boats—and they are hurting. That's why I am a cosponsor of the Boating Jobs Preservation Act of 1991.

When I was first asked to support this bill, I was pretty skeptical. Removing a tax on boats costing over $100,000 didn't seem like a good idea. I decided to take some time to meet with members of Maryland's boating industry to get their point of view on the tax. They came to see me in my Baltimore office and really let me know how this tax is hurting the people of Maryland.

In just the last eight months, Maryland has lost over 50 boating businesses and hundreds of boating jobs. One small company, which once employed 20 Marylanders

building yachts, filed for bankruptcy just last month. I don't want to see any other Marylanders put out of work because the President and the Congress made a mistake last fall.

The boat luxury tax isn't just putting people out of work, it might not be raising any revenue at all. Studies show that the lost tax revenues from decreased boat sales may be larger than that collected from the luxury tax. If this tax isn't raising any money to help balance our budget, why do we have it?

The Boating Jobs Preservation Act will help keep boating jobs, and keep them in the United States. I hear that Bermuda has eliminated all taxes on new boats sold there to lure business out of this country. That means more American jobs moving overseas. I've seen enough of that. We need to create good jobs in this country, not keep shipping them overseas.

Mr. Chairman, I am supporting the Boating Jobs Preservation Act because it is clear that Congress made a mistake last Fall. We need to stand up and admit that the boat luxury tax is hurting Maryland and hurting America. Let's repeal this tax before any more boating jobs are lost.

Prepared Statement of Denis F. Mullane

Mr. Chairman, members of the Subcommittee, my name is Denis Mullane. I am Chief Executive Officer and President of the Connecticut Mutual Life Insurance Company. Founded in 1846, Connecticut Mutual is headquartered in Hartford, Connecticut. with $11.8 billion in assets, is one of the oldest and largest life insurers in the United States.

Thank you for giving me the opportunity today to add my comments to those of your colleagues, including our own Senator Lieberman, and my colleagues in the life insurance business. I do not want to repeat their articulate and persuasive arguments in support of this legislation—so I will be brief—but not so brief as to fail to acknowledge Senator Bradley's leadership in sponsoring this legislation. He and his highly competent staff are to be commended for their hard work in securing the impressive bipartisan support this bill enjoys.

For my part, I would like to emphasize two—perhaps not readily obvious, but nevertheless substantial reasons—for supporting this legislation.

First, this bill will encourage insurers to make living life insurance benefits available to current policyholders—individuals and their families who are already faced with the tragic costs of a terminal illness: "tragic" because these costs are incurred out of desperate hope, and "tragic" because all too often that hope is disappointed.

By definition, life insurance is sold only to healthy individuals with a reasonably lengthy life expectancy. We often wish it were otherwise; but, were it so, life insurance would be prohibitively expensive or, more likely, a bankrupt enterprise undeserving of the responsibility of managing policyholder dollars.

This legislation will encourage insurers to give policyholders, regardless of their current state of health, the option to elect the prepayment of what would otherwise be life insurance death proceeds.

Actuarially, I am advised that it is a predictable and prudently assumable risk to offer this election to current policyholders who are terminally ill—that is, individuals who, because of the state of their health, are uninsurable, unable to purchase either health or life insurance.

However the uncertainty of current federal tax laws prevents us from offering this election as a provision for almost one million, existing Connecticut Mutual individual policies. A substantial question exists as to whether amending existing Connecticut Mutual life insurance policies to provide living benefits would disqualify the Company for taxation as a life insurance company. This risk of disqualification is too great for prudent management to assume.

This legislation removes the uncertainty and, as a result, offers the opportunity for living benefits to individuals who may already be suffering from a terminal illness.

A second, less dramatic, but no less significant reason for supporting this legislation is the added stability it will offer an industry which, like many others, is making tough decisions concerning employment and expenses in order to compete effectively with other financial institutions during this recession.

Our ability to make a living benefits rider available to our policyholders will contribute significantly to our financial stability and to that of the life insurance industry generally.

Life insurance was never intended to be, and should not be viewed, as a short term investment. It is a long term commitment to the financial future of a family or

a business. This legislation encourages policyholders to view life insurance—as it should be viewed—as a long term commitment to their financial security. This view of the proper function of life insurance will permit life insurance companies themselves to avoid some of the problems they experience when policyholders are encouraged—by the tax laws or otherwise—to treat their policies as demand deposits.

In conclusion—and by way of summary—two reasons for your serious consideration and support of this bill are:

First, it would encourage the availability of funds to policyholders who cannot, because they are terminally ill, currently purchase additional insurance; and

Second, it will, in a small but significant manner, contribute to the stability of that sector of the financial services community represented by life insurers.

Thank you very much for your time and attention.

PREPARED STATEMENT OF JEFF W. NAPIER

Mr. Chairman and members of the Committee, let me thank you for the prompt hearing you have scheduled on this legislation to stop the tremendous job loss in the recreational boating industry occasioned by a 10% excise tax on certain boating products, combined with the effects of a severe recession.

Congress sometimes makes big mistakes in its policy decisions. It made one last year in the budget package during the heat of an election campaign. The budget package was crafted without the usual Congressional hearings. Most members of Congress didn't get to participate.

The political need for share-the-pain, tax-the-rich symbolism in the budget package resulted initially in a 10% so-called "luxury tax" on certain items including boats. This, notwithstanding the well-established fact that such excise taxes are regressive and ultimately destroy jobs and tax revenues alike. Ultimately, the budget package did tax the rich directly by raising the tax rates but, by that time, it was too close to election to redo the tax package and remove the excise tax before the floor votes.

Had hearings been held on the boat excise tax, Congress would have heard about the British and Italian experience with such taxes: the boating industries in these countries immediately became severely depressed, thousands of jobs were lost, tax revenues were actually less than before the tax, and the cost of collection was greater than the tax yield. A losing policy all-around.

(I would ask the Committee's permission to introduce further detailed information into the record on the tax experience in these countries, along with other information to supplement my verbal comments.)

All of these same things have happened now in the U.S. boating industry; we estimate that 19,000 jobs at the manufacturing, distribution and retail levels have been lost due to the excise tax. I would note that this is double the number of jobs we had predicted would be lost last Fall when the concept was under discussion and before enactment.

The sales for much of the boating industry by its nature, cyclical with the economic times—are down about 40% or more across the board from 3 years ago. As a big ticket, discretionary income durable product, boats are extremely price sensitive. Department of Commerce studies, subsequently reconfirmed by proprietary company marketing studies, consistently indicate a 2 to 1 elasticity factor—that is, sales go down 2% for every 1% increase in price—no matter the reason for the price increase. Thus, we expected sales of product subject to the 10% excise tax would go down 20%. In fact, they have gone down 25% in addition to the 40% loss produced by the recession. That is to say, sales of the bigger boats subject to the tax are off an astonishing 65% from the average annual sales for the 4 years preceding the recession. Clearly, this is the result of the excise tax.

A few more specific examples: In the first calendar quarter of 1990, retailers in the Pacific Northwest region served by the Northwest Marine Trades Association, sold $29 million worth of boats of a value covered by the excise tax. In the same first-quarter of 1991, only $3 million worth of such boats were sold. Note that the Pacific Northwest region is not anywhere near as greatly affected by recession as the rest of the country. One can only conclude that the excise tax made the difference. Indeed, boat retailers and prospective purchasers alike, suggest that is the reason.

At the opposite end of the country in the state with the biggest boating market, Florida, sales of larger boats have similarly plummeted due to the tax. Meanwhile,

only a few miles off the shore of Florida in the Bahamas, Prime Minister Pindling has announced a program of further reducing Bahamian taxes on boats to a level well-below the new U.S. excise tax, along with the building of new marinas, all as a part of that government's effort to create jobs from the sales, servicing and tourism involved in boating. What a contrast in government tax policies and job creation vs. job destruction!

The strong domestic market which the U.S. boating industry had enjoyed in recent years gave us economies of scale in our manufacturing processes which made us very competitive internationally. The U.S. boating industry is one of the few U.S. manufacturing industries with a favorable balance of trade, including even with Japan. But now, these economies of scale and our competitive advantage are slipping away as a result of the 10% excise tax devastating the domestic market. Once again, we are the losers.

Finally, the tax yield which the budget package attributes to the excise tax just isn't there but, rather, a net revenue loss occurs. In the first instance, various former IRS officials have suggested that the cost of collection alone will exceed any tax to be generated. Secondly, the severely depressed sales will reduce the tax revenue yield below original estimates based on projected strong industry sales. Third, and probably largest of all, the corporate and personal income taxes no longer paid by bankrupt boat companies and 19,000 unemployed boating industry workers amount to tens of millions of dollars of revenue loss to the government. In addition, they amount of millions of dollars worth of unemployment claims to the states—which may be viewed as an additional revenue loss to government. And finally, the five hundred million dollars worth of favorable balance of trade the boating industry contributed to the United States international balance of payments deficit is being lost.

Far from taxing the rich, the excise tax on boats is hurting the little guy—unemploying 19,000 blue-collar and sales people. Far from yielding money to the government, it is a net loss probably in excess of $30 million. The British and Italian governments recognized the error of their tax policy and in the case of Britain, repealed their excise tax totally, and in the case of Italy, reduced it substantially. Not surprisingly, both industries returned to prosperity and again generated tax revenues for their respective governments while reemploying thousands of people.

We urge swift passage of S. 649 before the opportunity of the industry to recover and re-group is totally lost in bankruptcies and before the government loses tens of millions of dollars more in revenue and defaulted SBA loans from this bad policy. For the sake of American jobs, please favorably report S. 649. Mr. Chairman, if I may, I would like to express particular thanks to Senators Bentsen, Mitchell, Chafee, Dole and Breaux for their interest in this matter. All have significant boating industry unemployment in their states as a result of the excise tax and are understandably concerned, as we are, that remedy be provided quickly.

THE PRICE ELASTICITY OF BOATING PRODUCTS IS 2.00

A price elasticity ratio of 2.00 for boating products simply means that if the price of such products increases by 1% greater than the current rate of inflation, sales go down by 2%.

This has proved to be the case historically in terms of consistent marketplace experience—whether price increases are due to labor or materials cost increases, taxes or whatever. Accordingly, while prices have increased at varying rates over the years, more in times of high inflation due to cost push than in times of lesser inflation, manufacturers and retailers in the boating industry have tried hard to limit price increases to a maximum of the current rate of inflation. Basically, marine product manufacturers and retailers recognize in their pricing decisions that they cannot increase more than the current inflation rate unless they create a volume reduction.

This, rule-of-thumb experience has been studied and quantified by both the industry itself in proprietary studies and by private and government agencies over the last forty years. For example, the Conference Board has conducted several such studies covering the time periods of 1948 to 1965, and 1960 to 1975 in connection with the Department of Commerce. These studies consistently yielded price elasticity ratios of 2.00 or more for the sporting goods categories of the Bureau of Censes containing boats. Similarly, a study by Dr. David Raboy on "Results of an Economic Analysis of Proposed Excise Taxes on Boats" originally conducted in 1987 and updated in 1990, reached the same conclusion as does a study by The Futurers Group entitled "Consumer Spending on Pleasure Craft Boats: Price and Income Elasticities" done in 1987.

Finally, actual experience with excise taxes on boats in the U.K. and Italy have shown that sales fall by double the amount of tax; when the taxes were repealed sales rebounded to earlier pre-tax levels.

These studies and actual marketplace experiences would suggest that sales of boats subject to the 10% federal excise tax beginning January 1, 1991, would be 20% worse than the recession level sales of other boats not currently subject to the tax. In fact, this is exactly the experience in comparing sales results for the first-quarter of 1991; sales of smaller boats not subject to the tax are down 40% or 50% depending on boat brand, type and geographic region, whereas sales of bigger boats subject to the tax are down 60% to 70%.

The consistency of these studies and the historical experience with current experience presents clear and convincing evidence that the current 10% tax has dropped the sales of affected boats 20% below what it would otherwise be in these recessionary times; it has made the recession and job loss that much worse.

EFFECT OF EXCISE TAX

Survey Results of
Representative Sample of Boat Builders
Subject to 10% Excise Tax

I. **TERMINATIONS OF EMPLOYEES AT BOAT MANUFACTURERS SINCE JANUARY 1, 1991.**

(1) Number of companies reporting: 64
(2) Terminations: 4233
(3) Average annual compensation: $23,112
(4) Total annual wages lost: $97,796,860

	1990*	1991	% Change
II. UNIT SALES SINCE JANUARY 1, 1991:			
(1) All $100,000 plus sales	1835	712	- 61%
(2) $300,000 plus average price boats	321	41	- 87%
III. SALES IN DOLLARS SINCE JANUARY 1, 1991:			
- All sales of $100,000 boats	$517mm	$157mm	- 70%

* 1990 sales levels reflect depressed recessionary conditions; 1991 figures are worse due to additional burden of 10% excise tax.

JWN/cac-w14
June 1991

401 North Michigan Avenue • 312/836-4747
Chicago, Illinois 60611 • Fax: 312/329-9815

GE Capital

The GE Capital Recreational Boat Market Analysis

This quarterly market analysis was compiled by GE Capital. It represents inventory sold by recreational boat dealers who finance inventory with Distribution Financial Services. The price points shown in the analysis reflect the original wholesale invoice amount.

MARINE PRODUCTS (In Thousands)	New England	Southeast	Mid Atlantic	Midwest	Southwest	West
Less than $15	85%	78%	82%	91%	88%	83%
$16-25	10%	11%	10%	5%	7%	10%
$26-50	2%	7%	5%	3%	3%	5%
$51-75	1%	2%	2%	0%	1%	1%
$76-100	1%	1%	1%	1%	0%	1%
Over $100	0%	1%	1%	1%	0%	1%

NEW ENGLAND: CT, DE, ME, MA, NH, NJ, NY, RI, VT

SOUTHEAST: AL, FL, GA, MS, NC, SC

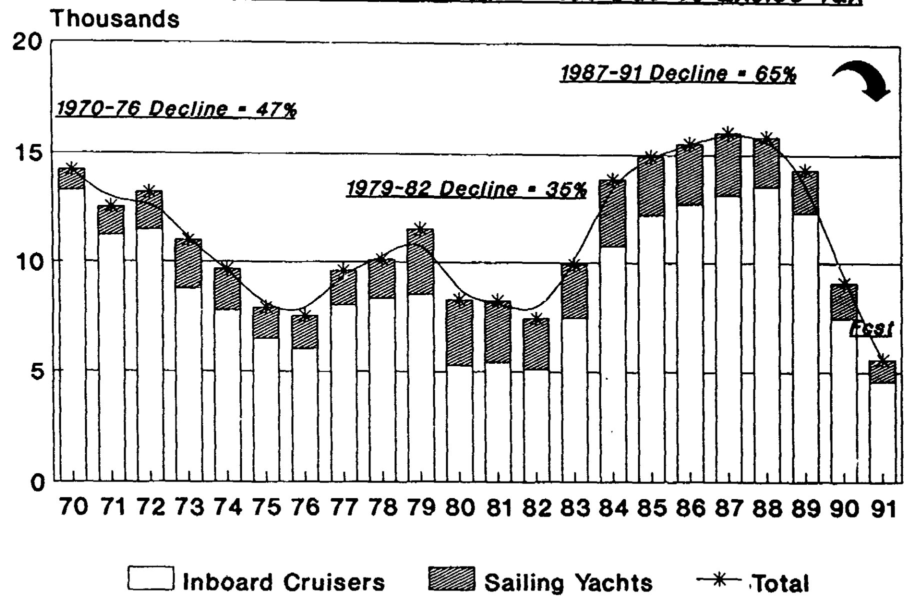
MID ATLANTIC: DC, IN, KY, MD, OH, PA, TN, VA, WV

MIDWEST: IL, IA, MI, MN, ND, SD, WI

SOUTHWEST: AR, CO, KS, LA, MO, NE, NM, OK, TX

WEST: AK, AZ, CA, HI, ID, MT, NV, OR, UT, WA, WY

1st Quarter
1991



Unit Boat Shipments ($100,000+)
Peak to Trough of Recession Cycles
1991 Worse Than Historical Experience Due To Excise Tax
Thousands
20
15
10
5
0
1987-91 Decline = 65%
1970-76 Decline = 47%
1979-82 Decline = 35%
Fcst
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91
Inboard Cruisers
Sailing Yachts
Total
Source: National Marine Mfg. Assn.

First returns: sales off 86 percent

By Bess Zarafonitis
Staff Writer

Information from 74 marine dealers in 11 states show sales of boats subject to the new luxury tax down by an average of 86 percent in the first quarter of 1991, compared with the same period the previous year.

The figures, collected through state trade associations and assembled by the Advisory Council of Marine Associations (ACMA), reflect a corresponding 89 percent drop in the total sales value of boats in the taxable range, from $94.8 million in 1990 to $11.8 million in 1991.

The 74 dealerships also say they employed 512 fewer people in the first three months of 1991, a 38 percent decline from 1990.

Though they acknowledge several factors have been depressing sales, industry leaders overwhelmingly cite the luxury tax for the dramatic drop in large boat sales.

> "It is far more devastating than I ever dreamed it was going to be."
>
> Phil Keeter, MRAA director

The 10 percent tax applies to the price of new boats over $100,000.

"It's far more devastating than I ever dreamed it was going to be," said Phil Keeter, executive director of the Marine Retailers Association of America (MRAA).

The MRAA distributed the statistics at the National Marine Manufacturers Association's (NMMA) annual legislative conference in Washington, D.C.

The mid-May conference focused on the luxury tax and Coast Guard user fee repeal campaigns, and some industry members used the ACMA figures in lobbying on Capitol Hill.

Keeter later presented the numbers at the National Marine Trades Council annual meeting in Newport, R.I., May 16-19.

The figures are the first made public by the industry that attempt to assess the impact of the tax on a state-by-state basis.

The NMMA, which for months has predicted the tax would eliminate up to 8,000 jobs nationally, recently adjusted that number to 19,000.

The losses will occur this year in manufacturing, retailing and service sectors, as well as in supplier networks, according to the NMMA.

The projection is based on NMMA's analysis that most U.S. boat sales in the taxable range are inboard-powered cabin cruisers and on actual late 1990 and early 1991 sales reports by 33 big boat manufacturers. The NMMA estimated the total sales value of inboard cruisers would drop to $816 million this year from $1.383 billion in 1990.

The ACMA sales and employment numbers do not necessarily reflect activity of all large boat dealers in the reporting states.

The report also does not address whether a surge of big boat deals occurred in late 1990, in anticipation of the luxury tax, offsetting declines in the first quarter of 1991.

The tax went into effect on Jan. 1 this year.

Robert Giesler, president of All Seasons Marine Inc., South Haven, Mich., and the ACMA co-chairman who collected the retailers' figures, said several other states dealing large numbers of big boats in the past did not report this year's sales before the findings were released.

Giesler said dealers in several other states, such as Louisiana, traditionally have not sold the boats now subject to the tax.

The ACMA numbers include sailboat and powerboat sales, Giesler said. They indicate a drop in the average sales value of boats sold by the dealers in the 11 states, from $215,301 in 1990 to $193,567 in 1991.

Giesler said the decrease may mean the tax is having less impact on boats priced in the $100,000-$150,000 range than on more expensive models. ■

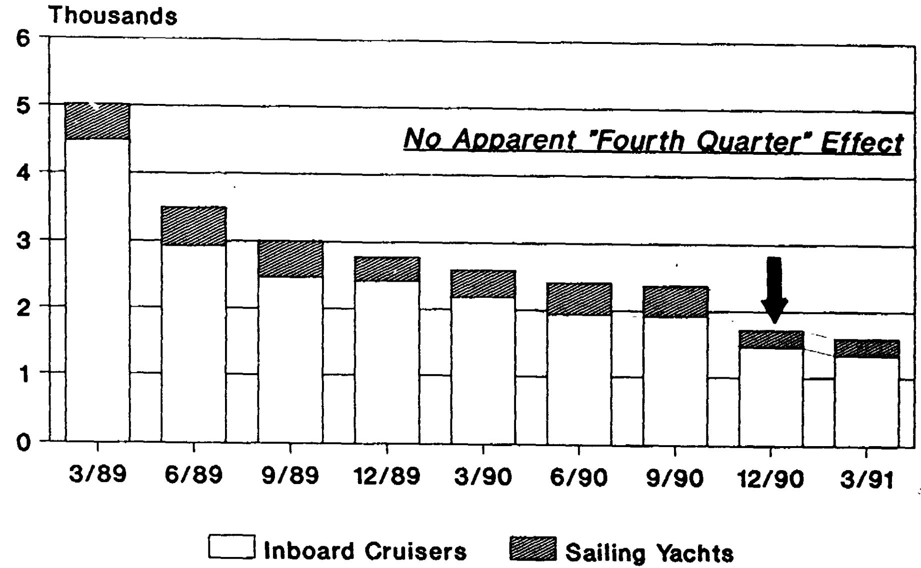
FIRST QUARTER SALES OF BOATS OVER $100,000

States	Dealers Reporting*	Units 1990	Units 1991	Sales in millions 1990	Sales in millions 1991	Employees 1990	Employees 1991
California	15	61	6	$16.8	$ 1.2	133	71
Connecticut	8	33	3	7.9	0.5	124	84
Florida	6	16	6	3.4	0.8	12	7
Kentucky	1	6	0	0.8	0.0	21	10
Massachusetts	9	33	7	6.7	1.0	208	121
Michigan	10	59	9	13.7	2.3	531	318
Nevada	1	2	0	0.2	0.0	20	10
New York	8	82	4	14.8	0.5	84	54
Ohio	6	46	6	6.4	1.0	202	149
Texas	1	3	0	1.1	0.0	8	5
Washington	9	99	20	22.8	4.[illegible]	-	-
TOTAL	74	435	61	$94.8	$11.8	1,343	829

* May not reflect all dealers of boats subject to the excise tax.

SOURCE: Advisory Council of Marine Associations (ACMA)

318



Unit Boat Shipments ($100,000+)
By Quarter
Thousands
6
5
4
3
2
1
0
No Apparent "Fourth Quarter" Effect
3/89
6/89
9/89
12/89
3/90
6/90
9/90
12/90
3/91
Inboard Cruisers
Sailing Yachts
Source: National Marine Mfg. Assn.

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JUN 05 '91 13:23 NMMA+202+337 4572 P.1/1

/ WEDNESDAY, JUNE 5, 1991 The Washington Times EDITORIAL

That sinking feeling

Care for a look at "tax fairness" in action? Check out the effects of the new luxury tax on boats, a product of last year's budget agreement.

In their quest to reach a deal, lawmakers signed onto taxes to raise money from automobile users and beer drinkers and cigarette smokers. But these are regressive taxes, disproportionately affecting low-income citizens, a problem at election time.

So lawmakers and administration officials decided that poor folks wouldn't mind paying more in taxes if only they knew rich people were being soaked too. That led to a federal luxury tax on cars and planes and, yes, boats that cost more than $100,000. The Joint Taxation Committee came out with all kinds of reassuring data about the increased revenues lawmakers could expect. On a $200,000 boat, the tax amounts to $10,000 — mere pocket change for the kind of corporate yachtsmen that negotiators assumed were buying these boats.

But it wasn't long after the tax took effect in January that the whole scheme began taking on water. People stopped buying new boats. They bought used ones, or they did their shopping in the Bahamas, whose government was lowering boat taxes about the time the United States was raising them. A once-bustling boat yard in Connecticut was "virtually abandoned," the New York Times reported, and "a strange quiet" filled the air. A Carver Boat Co. subsidiary in Rocky Mount, N.C., shut down production in February. Pearson Yachts Corp. of Rhode Island, the world's oldest builder of Fiberglas boats, filed for bankruptcy in March. And the distress signals continue to mount as the tax hits an industry already suffering from the recession.

With shutdowns have come layoffs — the blue-collar kind. The National Marine Manufacturers Association, which originally predicted that the tax would cost 8,000 people their jobs, has since raised the number to 19,000. Obviously putting people out of work hasn't done much for federal revenue enhancement: Jobless people don't pay much in income or sales taxes. Nor has it done anything for one of this nation's net-export industries except cripple it.

But the larger point is that when the feds set out to soak the rich in this case, a lot of non-rich people took a bath. "Rich people don't build boats," one boat maker told Insight magazine. "The average working man builds boats. Nobody in our company owns a Hatteras yacht. Unfortunately, it's the working person that is paying the price of this luxury tax." Scores of lawmakers have signed up to repeal this version of tax fairness, 90 House members from both sides of the aisle at last count. The Senate Finance Committee has scheduled hearings on the tax for next week. We hope the jobless find that comforting.

BANGOR, ME
NEWS
D. 81,132—S 98,493
BANGOR METROPOLITAN AREA

JAN 6 1991

New luxury tax on boats costing jobs in Maine

PORTLAND (AP) — The federal government's new 10 percent luxury tax on boats that cost more than $100,000 has hurt Maine's already-depressed boat building industry, forcing employee layoffs.

"This tax just turns off the spigot on the American boat builder in an arbitrary way," said Hank Halsted, of the Hinckley Co., a luxury yacht builder in Southwest Harbor.

Halsted said he knows of four boat orders his company has lost for 1991 because of the new tax. The lost orders, he said, have resulted in five or six workers being laid off.

Halsted, whose company sells 15 to 18 boats a year in the $350,000 to $1.4 million price range, said the law was designed to get money from the rich, but instead will hurt the working men and women who lose jobs because of it.

Maine is home to dozens of boat builders. Some build scores of boats a year, others make only one or two to stay in business.

While there are no exact figures, it is estimated there are about 100 boats built in Maine each year with price tags of more than $100,000. Each boat order can employ many workers for months at a time.

The tax, which has drawn protests from the boat building industry, was enacted last fall as part of the budget compromise aimed at reducing the federal deficit. The tax is applied to the portion of retail prices that exceeds $100,000 on new boats sold in the United States.

Boat builders say the tax has hurt an industry already struggling from the effects of a sluggish economy.

"How much you blame on the economy and how much you blame on the new tax, who knows?" said Philip Bennett, sales manager at Hinckley. "But it sure doesn't help."

The National Marine Manufacturers Association, a 1,700-member organization based in Chicago, estimated that 6,000 to 8,000 jobs will be lost in the boat building industry nationwide because of the new tax.

As the association spearheads a campaign to have the tax repealed, Maine boat builders have launched a letter-writing campaign to enlist the support of the state's congressional delegation for such an effort.

In a recent letter to Senate Majority Leader George J. Mitchell, Timothy Hodgdon, president of Hodgdon Yachts Inc. in Boothbay Harbor, wrote that many boat builders will go out of business in the next year, tax or no tax.

NOV 15 1990

Economic Slowdown Strikes

Downeast Boat Builders Looking at Hard Times

By Stephen Rappaport

What do President George Bush, Charles Keating of savings and loan fame, and Alan Greenspan, chairman of the Federal Reserve Board, have in common other than familiar names to readers of the financial pages? If you ask some local boat builders, one of them—or all of them combined—is the villain in what looks like a drastic slowdown in the local boat building business.

As oil prices climb, and economists debate whether the U.S. is entering a recession or . already is one, most Downeast boat builders have no doubt about the answer. Business is bad, and few people see a quick turnaround.

Arvid Young, one of the three Young brothers who have been building Ernest Libby, Jr.-designed fishing boats and "lobster yachts" in Corea for some 15 years put it succinctly not long ago. "We're just about shut down. The doors are closed," Young said while unloading the day's haul of lobsters at the Corea Lobster Cooperative one morning last month.

Although there were plenty of inquiries, orders for new Young Brothers boats were few and far between, Young said. He placed the blame for the situation squarely on the banking industry. "They just won't make loans," he complained.

Bruce Grindle, production supervisor for Flye Point Marine, Inc., echoed Young's thoughts. "The banks just aren't lending money," he said on a quiet morning in his office at the Brooklin boat builder.

Why aren't the banks lending? Grindle feels a big part of the problem is that bankers are being very cautious who they lend to because of the savings and loan industry scandal. The falling real estate market has also put pressure on the banks, he said.

Flye Point Marine, which has shipped boats as far away as Alaska and Antigua, is feeling the pinch, according to Grindle. Although they have firm orders for five or six boats, there is no backlog. "At this time of year, we should be full up 'til spring, but we're not," Grindle said.

One of Flye Point's regular customers is Otis Enterprises, Inc., in Searsport, a company which builds its own 43-footer and finishes smaller Flye Point hulls. According to Grindle, Otis has no orders at all.

Continued on Page 11, Section II

Economic Slowdown Strikes

Area Boat Builders Look at Hard Times

Continued from Page 1

"Keith's just put one of his 42's in the shop to finish on spec," Grindle said.

The reduction in orders has forced Flye Point to lay off some of its employees, according to Grindle. "We've cut our work force just about in half," he said.

Flye Point isn't the only boat builder that has let people go. "A year ago, we had 48 on our crew, now we're down to just about 28, including me," said Richard Duffy, whose Duffy & Duffy Fiberglass Boats, Inc., is one of the largest builders of fishing boats and motor yachts in Downeast Maine.

In 1988, the company molded some 75 hulls between 28 and 42 feet and finished about 38, with the rest being shipped off for other builders or the owners to finish. This year, the company has molded 22 hulls, and has one or two more to go before year end. It is finishing just four boats in the shop.

Duffy is not optimistic about a resurgence of the boat building business, either. "I don't think it'll ever be the way it was again," he said recently after launching a 35-foot sport fisherman.

Next year, Duffy continued, he may start taking storage and repair work at his yard on Eggemoggin Reach. "That's something I've always stayed away from," he said.

As bleak as the picture is for some boat builders, others appear cautiously optimistic about the future.

David McGraw, president of Glas-Spec, Inc., of Surry says his company has orders for 18 boats, three for its GS-41's, developed from Osmond Beal's *Corned Hake*, and 13 for the boat's 34-foot little sister. Still, he is concerned about the future, largely because of the tight money situation and increased government regulation.

"It gets harder to stay in business every day," McGraw complained. "The government makes it so hard for the small businessman, they just don't want me to do business, and you can quote me," he continued.

Across the bay, in Southwest Harbor, Weldon Leonard of Mount Desert Island Boatworks, Inc., which builds both fishing boats and pleasure boats, expressed cautious optimism, also. He has a small crew, and his order book is full.

MDI Boatworks' shop was totally destroyed by fire last March. Since then, Leonard and his crew have been working out of Lee Wilbur's shop, but that may not be the case much longer. Leonard said he has found a piece of land to buy in Southwest Harbor, and if the bank and the planning board agree, he'll build a new shop. "Maybe I'm being foolish," he said, "but I think we'll be all right."

One factor which may affect some companies more than others is the new 10 percent excise tax imposed on the purchase of pleasure boats that cost more than $100,000. That describes the entire production of large custom yacht builders like Morris Yachts, Inc., and the Hinckley Co. of Southwest Harbor and Able Marine of Trenton.

Rigdon Reese, of the Hinckley Co., calls the tax "an outrageous example of throwing one industry to the wolves." According to Reese, estimates by the National Marine Manufacturers Association predict the tax will cost 6,000 jobs in the marine industry.

Reese said the boat business is "very bad, and it promises to get worse." Hinckley has been doing well during the past 18 months, he said, primarily with exports to Japan. The company hopes to increase its sales in the European market.

Reese sounded grim, however. "You don't have to be a Harvard-trained economist," he said, to know that when the economy is uncertain it's easy to postpone the decision to by a luxury boat.

The new excise tax and slowing economy will also have an impact on smaller builders of custom yachts, like Lee Wilbur and Ellis Yachts, both in Southwest Harbor, and the John R. Williams Co. in Hall Quarry. Even before the new tax, things were slow for several of those builders. "We have a lot of inquiries, but no orders for new boats," Cramer Fox, in charge of service at the Williams yard, said recently.

As might be expected, the cutback in boat building has had an effect on suppliers of the equipment that goes into new boats, like the Jordan-Milton Machinery Co., which sells Caterpillar diesel engines Downeast.

According to John Banks, manager of Jordan-Milton's power products division, 1990 marine diesel engine sales have declined about 30 percent in the past year. Banks forecasts another 10-15 percent drop for 1991, even though he expects some increase in the sale of engines to repower existing boats.

He points to a "credit crunch" as a major problem for boat buyers. "Our finance people are looking at deals a lot closer. They want ironclad promises about when they'll get paid, and how."

Hard times in the fishing industry are another problem. "A lot of guys [illegible]

SUNDAY SUN-JOURNAL

LEWISTON, ME
SUNDAY 43,470

MAR 17 1991

New taxes translate to lost jobs

Few people think of the labor that goes into their boats when out on the water fishing, cruising or merely sunning the family. As with all consumer products, however, boat building, retailing and servicing creates jobs - as many as an estimated 600,000 across the United States during such peak production years as 1988. Today, that worker total has slipped by more than 100,000.

In Maine, an estimated 11,432 people are employed in all phases of the recreational boating industry. Boating can mean a start for high school students as dock hands at marinas, for entrepreneurs at marine dealerships, and white collar jobs for salespeople, executives and engineers. Businesses allied to the industry employ people in publishing, finance, insurance, chemicals, metals and electronics.

Boating is a cyclical industry with swings from growth to contraction. As the market cooled in 1989 and 1990, production fell by over 40 percent in that period and jobs were lost. Adding to the problem are recent actions by the federal government placing an excise tax on large craft, user fees on all boats 16-feet and longer, and a gasoline tax increase paid by all motorboat users.

National Marine Manufacturer's Association president Jeff Napier explained that members of the industry will be joining forces with boating consumers to work for repeal of the new taxes. "Our motivation is clearly focused: to help insure that current industry jobs will be preserved and that those lost may be regained," Napier said.

NOV 1 1990

...xury tax on pleasure ...ats may lead to layoffs

by Arthur B. Layton Jr.

The 10 percent luxury tax ...aced on yachts in the newly ...assed Budget Reconciliation ...ill is expected to further ...epress an already depressed ...oat building industry.

The bill passed by Congress ...st weekend contains a pleasure ...oat tax fee schedule in addition ...the luxury tax to be applied to ...ew pleasure boats costing more ...an $100,000.

Rigdon Reese, marketing ...irector for The Hinckley Co. in ...outhwest Harbor, predicted lay...offs and business failures in the ...U.S. boat building industry because of the tax. He said he is not aware of any layoff plans at Hinckley, but the luxury tax will hurt business for Hinckley and other Maine builders.

"It is perhaps the most obvious example of the government singling out one or two industries as scapegoats in order to make a public relations statement to the folks back home in Peoria that they've done their job in taxing the rich," Reese said this week.

The not-so-rich who buy the bulk of boats in the United States, he said, will delay their purchases. The wealthier boat buyers are in the best position to avoid the tax, according to Reese, since they can establish offshore corporations or commercial ventures to avoid the tax.

The big luxury sailboat market in the United States accounts for $25 million to $30 million in sales annually, according to Reese who said if powerboats are added the entire market is probably $100 million.

"That's about $10 million in taxes and the Pentagon frequently spends that amount before breakfast," he said.

Reese was indirectly agreeing with a forecast last week by the National Marine Manufacturers

■ see TAX page A8

TAX ■ from page A1

Association in Chicago.

The association predicted 12,000 layoffs in the U.S. industry and hundreds of layoffs in Maine, if Congress passed the tax.

Congress passed the bill last weekend.

There is also no exemption for commercial fishing vessels in the new fuel tax increase, according to Kathryn Gest, an aide to U.S. Sen. William S. Cohen (R-Me.)

In the past, exemptions to fuel tax increases have been made for the fishermen and farmers, but not this time, according to Gest.

She said Cohen voted against the Budget Reconciliation Bill, because of cuts to Medicare which he believes will have an adverse impact on Maine hospitals.

U.S. Rep. Olympia Snowe and Rep. Joe Brennan also voted against the budget. Sen. George Mitchell voted for the Budget Reconciliation.

The fee schedule applies only to vessels operated on the navigable waters of the United States where the Coast Guard has a presence.

It gives whatever agency, private or public, that is designated to collect fees, the authority to charge not more than $25 for vessels between 16 feet and 20 feet. For vessels between 20 feet and 27 feet, the fee is not more than $35; between 27 feet and 40 feet, the fee is not more than $50; and for vessels 40 feet and more in length, not more than $100.

According to the Marine Manufacturers Association, the new federal boat tax will be an additional tax for Maine boat owners who already pay annual registration fees and municipal taxes for their pleasure boats.

There are 123,723 registered boats in Maine, according to the association.

Reese said there are four or five boatbuilding companies in North America that have closed their doors this year and with the new tax he expects more will follow.

"The same people who passed this tax are the same people who have been talking about improving the ability of U.S. companies to compete internationally. This new tax, by raising the cost of boats, certainly does not help us compete," he said.

"European countries are subsidizing their boat builders. The Finnish government pays for the advertising for Swan and Baltic," Reese said about two of Hinckley's international competitors.

"The American boat builder is not looking to its government for this type of help," he continued. "But at the same time it seems unfair for boat builders to have an additional 10 percent tax, in addition to state sales tax, imposed on the product of their labors, while at the same time not taxing polo ponies, condominiums in Aspen, airplanes and other clearly luxury items."

Hinckley President Robert Hinckley wrote a letter to Snowe two weeks ago protesting the proposed tax.

"We are apparently being sacrificed because we are a small industry with no strong lobbying group behind us," he wrote. "This proposal will do nothing but force large boat owners into offshore corporations thus purchasing out of the country. I can't help but think this is counterproductive to raising more taxes, and counterproductive to increasing employment."

The marine industry is already suffering in the present economic downturn, Hinckley wrote.

Some of the firms that have closed, filed Chapter 11, or have been in serious financial condition in the last few months are Tartan, Irwin, Bristol, O'Day, Cal, Ericson, Ocean Cruising, Shannon and Concordia, he said.

"There are several more that are reportedly close to closing. We at The Hinckley Co. are doing quite well, but have had to turn to the export market. One-third of our recent production has been sold to Japanese and European buyers," he wrote.

The National Marine Manufacturers Association was sharply critical of Mit... who voted for the reconciliation bill.

"Nationwide, the industry [boat] employment has already dropped ... 100,000 jobs, the result of a reces... which began for boating 18 months... We estimate this new tax would th... another 12,000 workers out of j... including several hundred in Maine... association said. "We have called ... the senator to consider the capital g... tax reduction on its own merit, not... penalty of lost jobs to hardworking... and women in the boating industry."

The association claims the luxur... is designed to provide tax-the rich... tion cover to compensate for a cut in... capital gains tax rate.

The 10 percent tax is applied to... amount of a boat's price that is more... $100,000, according to Kristin Amer... an aide to Mitchell in Washington.

If a person pays $250,000 for a boat, the tax is applied only to $150,000 in excess of $100,000... explained.

Amerling said the original prop... called for a plateau of $30,000 for ... But Mitchell succeeded in raising... plateau to $100,000, she said.

Mitchell this week said that whil... bill was not perfect, it was a step in... right direction.

"This budget is a major piece of l... lation, containing hundreds of provi... which affect people in countless w... he said. "There are many provi... affecting Maine citizens, the eld... working families, and others, wh... would have preferred not be included...

In some cases we were able to ... certain provisions such as the home... ing oil tax which would have hurt... England. In other cases we were... successful in modifying certain p... sions that would have a particular i... on Maine such as the luxury tax on... or the excise tax on gasoline."

Boat/U.S., a boat owners lobb... Alexandria, Va., blames the pleasure... fees on Rep. Leon Panetta (D-Ca...), Rep. Sam Gibbons (D-Fla.), and ... Bill Frenzel (R-Minn.) Boat/U.S. ... the origin of the boat fee proposal ... mer President Reagan's budget dir... David Stockman. □

MAINE SUNDAY TELEGRAM

PORTLAND, ME
SUNDAY 130,893

MAR 24 1991

Mitchell says Robb controversy's been overplayed

Steve Campbell

Washington Watch

WASHINGTON – The press has its flaws, to be sure, but all too often reporters become the target of misdirected attacks. Call it friendly fire.

Such is the case with a controversy involving Senate Majority Leader George J. Mitchell.

Mitchell says the press has blown out of proportion a controversial decision by Democratic leaders to drop Virginia Sen. Charles S. Robb, a Democrat, from the Senate Budget Committee.

Mitchell and Tennessee Sen. Jim Sasser, the Budget Committee chairman, say Robb was dropped to reduce the size of the panel. It had become unwieldy, they say. But Robb and his aides believe the removal is backlash against the senator's fiscal conservatism, and others have suggested that it is the result of Robb's support of President Bush in the Persian Gulf war.

"I have been just amazed at all of the press publicity that has been given to it," said Mitchell in an interview last week. "I must say that it's been blown completely out of proportion and much of what has been written in the press has been inaccurate."

But a top Democratic Senate aide said Mitchell's criticism is misdirected. His gripe should be with Robb, said the aide, not the media.

Consider how the story unfolded:

The controversy began nearly two weeks ago, when Robb, appearing on "Meet The Press," was asked if he thought his dismissal from the Budget Committee was designed to punish him for being one of the few Democrats who voted to support President Bush's use of force against Iraq.

Robb said there is "a lot of anxiety between those (Democrats) who did vote for the war and those who didn't," but that he believed the issues were unrelated.

The next day, Robb was quoted in The Washington Post suggesting his dismissal was caused by his attempts to push for deeper spending cuts than other Democrats on the Budget Committee, and his unhappiness with the way the Democrats handled last year's budget summit.

After voicing discontent about the budget summit, Robb said, "I knew from then that (Sasser) felt it would be easier to work without me."

Later in the week, Robb spokesman Steve Johnson told a Capitol Hill newspaper, Roll Call, that Robb was "very, very upset" by his removal, and added that "privately (Sasser) said that Robb had not gone to bat for him, so he wasn't going to go to bat for (Robb)."

Robb and his aides continued to discuss the controversy with several other newspaper reporters, leading to such headlines as, "Was Sen. Robb ambushed or not?" and "Mitchell says it's innocent."

Mitchell and Sasser offered a reasonable response.

First off, Mitchell takes issue with the press characterization that this is an unusual event, pointing out that 10 years ago Mitchell himself was removed from the budget panel.

Further, Mitchell said that since becoming majority leader he has worked to reduce the sizes of all committees, in an effort to get senators to focus their attention on fewer committees rather than spreading themselves thin.

Additionally, Mitchell said Sasser suggested more than two years ago that the Budget Committee be reduced from its 23 members because it had become unwieldy.

That opportunity arose r[illegible]ently when New Hampshire Sen. Warren Rudman resigned from the panel and the Republicans decided not to fill the position. As a result, the Democrats needed to eliminate a seat and chose Robb, the committee's most junior member.

Mitchell points out that he has "great confidence" in Robb, noting that he appointed the Virginia senator last year to head the Democratic Senatorial Campaign Committee, a plum assignment that Mitchell once held.

It's unlikely that Mitchell or Sasser dropped R[illegible] because of his war vote or conservative views, but it is not the press that is to blame for continuing this controversy. Robb, by repeatedly showing his unhappiness, is making the news. The press is simply covering the story. "(Mitchell) is being ill-used by Robb, who has put his own political future ahead of the issues and agenda of the Democratic Party," said a Senate Democratic aide.

As Robb himself told the Richmond Times-Dispatch last Sunday, "knowing how you in the press focus on the ironies of life, perhaps my remarks on the budget will carry a little more significance."

Mitchell seeks hearing on luxury tax repeal

If you're planning to purchase a luxury boat, you may want to wait.

Mitchell is considering a request by lobbyists of the boating industry to support a repeal of the new 10 percent luxury tax on boats that cost more than $100,000.

Heading the effort is the National Marine Manufacturers Association, whose president Jeff Napier said that "while intended to be a symbolic gesture to 'tax the rich' ... it is merely taxing thousands of jobs out of existence."

According to the group, more than 8,000 boat manufacturing workers will lose their jobs because of fewer boat purchases, in turn costing the government $30 million annually from lost corporate and payroll taxes.

The Joint Committee on Taxation recently estimated that the new tax would raise only $3 million in revenues in 1991, and $6 million in 1992.

In a letter to Texas Sen. Lloyd Bentsen, Mitchell has asked that a hearing be held to consider the issue.

"Over the last several weeks, I have heard from many people in the boating industry in Maine and across the nation and I believe they have raised legitimate questions about the wisdom of the new tax on boats," Mitchell wrote to Bentsen.

"If the tax does in fact result in a decline in boat sales, it would be counterproductive to our efforts to reduce the deficit," he said.

No word yet from Bentsen.

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BRUNSWICK, ME
TIMES RECORD
—D. 14,419—
PORTLAND METROPOLITAN AREA

Regressive new taxes

At first glance, few Mainers are likely to endorse a national campaign to repeal the new federal luxury tax on expensive boats. The 10 percent tax, which applies to that portion of a boat's retail price above $100,000, was enacted as part of the recent budget compromise.

The boat tax was aimed at the well-to-do Americans who can afford to buy boats costing $100,000 or more. But judging by comments from Maine boat builders, the tax has an unwelcome side effect: It is taking jobs away from the working men and women who build boats.

Hank Halsted of the Hinckley Co. in Southwest Harbor, which builds luxury yachts, says his company has lost four 1991 orders as a result of the new tax. That, in turn, resulted in layoffs of five or six workers. Nationwide, the National Marine Manufacturers Association estimates the new tax will result in the loss of up to 8,000 boat building jobs.

According to Christopher Evans, vice president of Sabre Yachts in South Casco, the new luxury tax on boats is unfair. "It's aimed at boat buyers and not at the broader range of luxury people can have, such as ski condos and luxury vacations." He's right, of course, but there is a broader point to consider.

The luxury tax on expensive boats, cars, jewelry and furs was but one element of the tax package enacted in October. Taxes for Medicare were increased, as were taxes on gasoline, diesel fuel, alcohol, tobacco, air travel and telephone calls.

Unlike the income tax, which is a progressive tax, most of the new revenue raisers are regressive. Although Congress did increase the top tax rate for the nation's wealthiest taxpayers from 28 percent to 31 percent, that is a far cry from the top rate of 70 percent in force just a decade ago. And as Maine's boat builders are discovering, even so-called luxury taxes can take a greater toll on working people than on wealthy consumers.

For many economists, tax progressivity is the truest measure of tax fairness. A tax is said to be progressive if it increases as a percentage of personal income as income rises. The next time Congress needs to raise revenue, fairness dictates that it be done via the federal income tax.

REPUBLICAN JOURNAL
BELFAST, ME
WEEKLY 6,995

FEB 14 1991

6 BURRELLE'S SF

Boat lobby battles user fees

8407

By Arthur B. Layton Jr.

BOAT/U.S., a 380,000-member, national lobbying group for recreational boaters, is asking boat owners to urge their congressional representatives to repeal the new federal boat user fee schedule which became effective Jan. 1.

A repeal bill, H.R. 534, has been introduced to Congress by Rep. Robert Davis (R-Mich.), the senior Republican member of the House Merchant Marine Committee which has jurisdiction over the U.S. Guard.

The bill is co-sponsored by Reps. Herb Bateman (R-Va.), Frank Pallone (D-N.J.), Bill Hughes (D-N.J.) and Robin Tallon (R-S.C.)

Mike Sciulla, BOAT/U.S. vice president, said this week that his Alexandria, Va.-based organization is trying to get as many members of Congress as possible to co-sponsor the repeal bill.

None of the revenue to be raised by the boat fee schedule will be used to defray Coast Guard operational costs or to defray any federal government costs related to maritime activity, Sciulla said in a telephone interview.

Annual fees range from $25 to $100 and are applied on a graduated scale to boats beginning at 16 feet in length which are operated in Coast Guard jurisdictional waters, regardless of the means of propulsion.

The fee schedule was proposed in 1981 by Office of Management and Budget Director David Stockman during the Reagan administration, according to Sciulla who said his organization has been fighting it ever since.

He said the fee schedule slipped through late last year along with the 10 percent luxury tax on yachts when Congress passed the Budget Reconciliation Bill.

The National Marine Manufacturers Association is still fighting the 10 percent luxury tax on the price of a yacht that is in excess of $100,000.

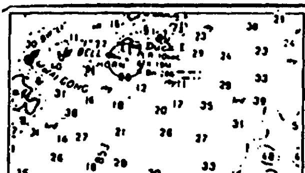
The Chicago-based organization estimates that there will be 8,000 layoffs in the marine industry because of the luxury tax.

The tax which, as did the fee schedule, became effective Jan. 1. ■

BAR HARBOR TIMES
BAR HARBOR, ME
WEEKLY

JAN 3 1991

BURRELLE'S



IN & OFF Soundings

By Arthur B. Layton Jr.

Anxiety over the possibility of war in the Middle East, which can begin anytime after Jan. 15 under conditions approved by the United Nations, has shoved the 101st Congress' Budget Bill well offstage, but not for the National Marine Manufacturers Association.

The 10 percent excise tax on the amount paid for a new yacht in excess of $100,000 became effective Jan. 1, accompanied by a 5-cent a gallon rise in the federal fuel tax and the establishment of Coast Guard user fees for boaters.

Maine builders and the marine manufacturers association agree that the new taxes and user fees could not have come at a much worse time. The boat building industry is still trying to claw its way out of a two-year recession.

The marine association, no stranger to Maine builders, has not given up. Last month the Chicago-based organization met with yacht builders to discuss strategy. Their object is to have the tax modified or rescinded this year.

Maine's custom and semi-custom builders have been relatively lucky during the downturn, but if there are any doubts about hard times nationally, here is a brief litany of woe.

Tartan Marine Inc., which has, probably more correctly had, 25 dealers in the Northeast and the Great Lakes, suspended production last September. The reason given was a sales slump in Tartan's once popular and affordable line of 28-feet to 41-feet, auxiliary sailboats.

Bristol Yacht Co., and its parent company, C.J. Pearson Co., both of Bristol, R.I., have shut down and gone into state receivership to protect themselves from creditors. The reason — a plummet in sales.

Canada's C&C, the sailboat and powerboat maker, finally called time-out last September, after nine months of financial struggle, and entered Canada's equivalent of U.S. Chapter II bankruptcy proceedings to reorganize itself.

The problems at C&C may be a little different, but the glut in the production boat market has not helped its financial position.

Ericson Inc., a California builder, foundered last spring. A subsidiary of Pacific Seacraft Corp. has acquired selected assets of the defunct company and plans to build Ericsons.

It may seem mean-spirited in Washington for boat builders to complain about a tax on the price of a new boat in excess of $100,000 when war abroad may be imminent and homeless people, racial friction and the educational system remain national problems.

But it is not mean-spirited, particularly in Maine where boat building existed long before Maine became a state. Drive four miles in any direction on Mt. Desert Island and you either pass a boat builder's home or a boat yard.

The out-of-state customers who support the island's industry could easily decide, with modern communications systems and financial arrangements, to buy their boats in Europe. It would be a severe blow to the area's economy. □

BAR HARBOR TIMES

BAR HARBOR, ME
WEEKLY 8,500

MAR 28 1991

Hinckley Co. weathers recession storm

by Arthur B. Layton Jr.

SOUTHWEST HARBOR — Henry R. Hinckley Co., the yacht building division of The Hinckley Co., has announced a new model, increased its advertising and beefed up its service yard business by adding the U.S. Navy to its client list.

That's the good news about how the yacht builder is coping with the nearly three-year-old recession in the boating industry.

The bad news is that Hinckley, which is one of Mt. Desert Island's largest employers, has still been affected somewhat by the economy.

"We're hurting along with everyone else in the industry," says Hinckley Marketing Director Rigdon Reese.

"Boat building is in a slump and it has been somewhat precipitated by our government which singled out the boating industry and walloped it with a huge tax," said Reese, referring to the 10 percent luxury tax Congress has placed on the price of a new yacht in excess of $100,000. The tax became effective Jan. 1.

The low end of the price range for Hinckley sailing yachts is more than $200,000.

The company, along with other Maine boat builders, the Maine Marine Trades Association, and the National Marine Manufacturers Association is fighting for repeal of the tax.

Ti Hack, The Hinckley Co.'s general manager, agreed emphatically that the tax has hurt business, but he also mentioned an unsettled general economy and the Persian Gulf war as deterrents to yacht sales.

"We'd like to have a bigger backstop," Hack says about the scarcity of back orders, which is a new experience for Hinckley.

Stepping up advertising, introducing new models, and expanding the company's service yard business is Hack's strategy to combat recession and the possibility of layoffs, if the luxury tax has the effect the boating industry says it will.

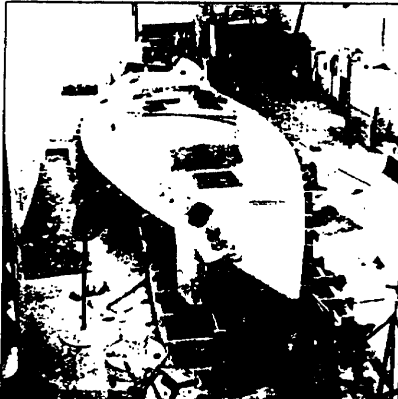
The strategy seems to be working.

Two new Hinckley 59s are scheduled to be launched in early May. Another 59 is scheduled to be launched in late summer.

Hinckley has an order from Japan for its Sou'wester 51 and an order for its new Sou'wester 52. The Sou'wester 52 order, from a Swiss customer, is a result of Hinckley's debut at the Dusseldorf Boat Show this January. And the company has begun construction on another power boat, a Salaria 42.

Last year, Hinckley came out with a stretch version of its Sou'wester 42, the Sou'wester 43 which won Sailing World Magazine's best-boat-of-the-year award in the 40-foot to 50-foot range.

The company now uses Kevlar (aramid fiber) in all of its hulls and decks to increase its competitive edge and has begun using carbon fiber spars instead of aluminum for the same reason. Kevlar, which is best known for its use in lightweight body armor and aerospace technology, produces a much stronger and lighter hull. Last spring, two Hinckley 59s, the largest Kevlar/E-Glass hybrid sailing yachts in the world, were built in the Hinckley glass shop.



Glass shop workers at The Hinckley Co. have been busy this winter making hull and deck molds for the company's new Sou'wester 52. This deck mold was nearing completion last week. ARTHUR B. LAYTON JR

Like the Sou'wester 43, the Sou'wester 52, a stretch version of the Sou'wester 51, is aimed at a changing yacht market. Hinckley's glass shop crew has been working nights and weekends to complete the hull and deck molds for the new model, in order to get it to the production line on schedule.

The 52 was designed for people looking for more cabin space, according to Hack who commented that in the past Hinckley has concentrated more on deck layout.

Roller-furling jibs and mainsails that disappear into masts and booms have reduced the need for stowage space on yachts.

"And women in the family, thank goodness, are having a bigger say in how things are laid out down below," Hack said. "They want a more functional galley and a bigger entertainment area."

Hack said the design was conceived as a result of the Genoa, Dusseldorf and London shows where people said they wanted a boat that they could sail themselves, but which had plenty of room for three couples.

In the Sou'wester 52, Hinckley has cut away the skeg on its Sou'wester 51, reversed its transom, straightened its bustle, and re-faired it to provide more effective sailing length; and deepened the spade rudder. The result is more room below and more speed, according to Reese.

■ see HINCKLEY page A15

HINCKLEY ■/from page A14

The mast step has been moved further aft to enlarge the foretriangle to minimize the overlap of the jib with the mainsail for ease in sail handling. The enlarged foretriangle is designed to eliminate the occasional nuisance of having to walk the jib around when tacking, and it is expected to improve the sailing response of what is designed to be a faster, easier-to-handle racer/cruiser, Reese said.

The stern lazarette, an integral part of the Sou'wester 51 design, has been chopped off and the auxiliary engine has been moved forward to a midship position.

The result is room to move both the cockpit and the master's cabin further aft which allows a Sou'wester 52 owner the option of three cabins below deck.

"We anticipate it will be faster on all points of sailing," Reese said about the new Sou'wester 52 whose deck mold was nearing completion in Hinckley's glass shop last week.

The first of the new model line is scheduled to be launched in late summer, he added.

In the meantime, Hinckley has just received approval from the U.S. Navy to repair its utility boats and captains' gigs. The gigs are similar to the yacht launches Hinckley produces.

Hinckley's service yard is already doing routine maintenance and repair work for the U.S. Coast Guard and has been doing work on Frenchman Bay Boating Co. vessels from Bar Harbor, according to Hack.

Hinckley, which has sales representatives in Japan and continental Europe, recently announced that Berthon International in Lymington, England, will handle its sales in England, Scotland, Wales and Ireland. □

BAR HARBOR TIMES

BAR HARBOR, ME
WEEKLY 8,500

NOV 15 1990

BURRELLE'S PO

IN & OFF Soundings

By Arthur B. Layton Jr.

The nation's boating industry may still have a chance to get itself unstuck from the goring horns of the Budget Reconciliation Bill recently passed by Congress.

That at least is the opinion of Keff Napier, president of the Chicago-based National Marine Manufacturers Association.

"The House only approved the bill by a vote of 228 to 200 and the Senate 54 to 45 — not a strong endorsement," Napier is quoted as saying in a recent news release sent to boat builders throughout the nation.

And then Napier warms to his point: "Many members of the House and Senate were already talking of revising the deal when the next Congress convenes in January —that's our cue to get both industry members and individual boaters working hard toward a repeal of these measures."

The measures he refers to are warmed-over news, but they are still hot items for an industry that has been taking a financial burning of various degrees for nearly two years.

The big burn, of course, is the 10 percent excise tax to be imposed on the portion of the retail price of a boat that is above $100,000.

Luxury boats, or yachts, are a hallmark of coastal Maine. Economic mainstream Americans, and recently Japanese mainstreamers, buy them in Maine because of the state's reputation for fine craftsmanship.

Maine is not in the economic mainstream of America which is why the yachts it builds have been internationally competitive.

It would be a tragedy if the new tax reduces Maine's access to the economic mainstream. The new tax may do just that.

You cannot get much of a yacht today for less than $100,000. They are not like automobiles.

Up to and in excess of 5,000 man-hours go into assembling a yacht, which accounts for $100,000 being not much of a price for a high-tech yacht. High-tech may not be necessary, but that is what customers want.

It only takes about 20 man-hours to assemble an automobile.

Congress has sealed shut anticipated loopholes. The only bright spot is that the tax only applies to the first sale which could aid sales of used boats.

The slow burn in the tax bill is expected to be the annual user fees that have been levied on boaters who operate in waters subject to Coast Guard jurisdiction.

Regardless of method of propulsion there will be an annual fee of $25 for boats 16 to 19 feet; $35 for boats 20 to 26 feet; $50 for boats 27 to 39 feet; and $100 for boats 40 feet and longer.

In return all they get is another bow sticker. □

CAMDEN, NJ
COURIER-POST
D. 101,737—S. 101,668
PHILADELPHIA METROPOLITAN AREA

MAR 23 199-

Boatbuilder cuts 50 more jobs

By BERNIE WEISENFELD
Courier-Post Staff

A Burlington County boatbuilder, its sales torpedoed by a new luxury tax, yesterday announced the layoff of 50 workers.

Viking Yacht Co. now employs about 250 people at its New Gretna boatyard, down from about 700 workers a year ago, a spokesman said. Layoffs in the past year have affected "all areas of the company from the executive level down," said spokesman Thomas Carroll.

Also, the company in January closed a facility in St. Petersburg, Fla., idling about 550 workers there. About 20 workers moved from the Florida facility to New Gretna as part of a consolidation program, Carroll said.

Viking blames the cutbacks on a new federal tax on boats costing more than $100,000.

At the same time, a "credit crunch" has made it more difficult to finance yacht purchases, said Carroll.

The tax, equal to 10 percent of a boat's purchase price, took effect Jan. 1 as part of an effort to reduce the nation's budget deficit.

"It's killing us, no doubt about it," Carroll said of the tax.

Viking's sales have fallen "60 percent or more" since the tax took effect. The company's yachts sell for $250,000 and up.

"It was a get-the-rich tax, but what it's done is get the working man right in the throat," he said.

The boatbuilding industry has lost about 12,000 jobs since the tax began, according to a survey by the National Marine Manufacturers Association, Carroll said.

Boatbuilders, who initially lobbied to block enactment of the tax, now are trying to repeal it, he said.

Meanwhile, overseas sales are keeping Viking afloat, Carroll said. "I'd say 70 percent of what I'm building is going to Europe," he said.

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BRADENTON, FL
HERALD
D. 40,912—S. 50,787
BRADENTON METROPOLITAN AREA

Wellcraft expects layoffs

CYNTHIA VAUGHN
Herald Business Writer

Wellcraft Marine employees were told Monday that its five south Manatee County plants will shut down Thursday until March 4, a worker who wished to remain anonymous said. One company executive said late Monday afternoon he had not heard about any layoff plans.

The explanation given for the layoffs was that management wants to see how many sales orders are generated at the large Miami Boat Show, which ends Wednesday, said the worker, who has been a reliable source in the past. He told *The Bradenton Herald* earlier this month that employees recently have been asked to work four-day weeks and shorter hours.

Employees of Wellcraft, 1651 Whitfield Ave., will receive no pay for the days off, the worker said.

"Attrition is taking its course, and we're not hiring," said Bill Mudgett, senior vice president of sales and marketing. He said he had not heard that any further layoffs are planned. 110 workers were laid off in November.

Other senior executives did not return telephone calls Monday.

A seven-day layoff does not qualify workers for assistance under federal or state labor laws, said Larry McIntyre, administrator for Program Evaluation Rapid Response for the Florida Department of Labor in Tallahassee.

Mudgett, who just returned from the Miami Boat Show, said that although attendance is down about 20 percent from last year, customers are spending more.

"People know the boats; they're doing their homework," he said.

"They're buying bigger boats" but staying below the $100,000 limit because of the new federal luxury tax on boats costing more than that, he said.

"We're seeing some light at the end of the tunnel."

Bradenton Herald file photo

Wellcraft employees will be out of work from Thursday until March 4.

March 1991

Carver halts production of boats over 36 feet

By Gary Beckett
Staff Writer

Officials of powerboat maker Carver Boat Co. in late February said they will temporarily suspend production of all models 36 feet and larger beginning April 26. Carver also plans to shut down its Californian Yachts subsidiary, based in Rocky Point, N.C., which builds 45- to 55-foot motoryachts.

Carver, a division of Dallas-based Miramar Marine Inc., will lay off the 235 remaining workers at the Rocky Mount plant. It also will dismiss 150 to 200 workers at Carver's 470,000-square-foot headquarters plant in Pulaski, Wis.

The planned cuts account for 40 percent of Carver's salaried personnel and 27 percent of its factory workers, said Dick Nocenti, Carver's vice president of marketing.

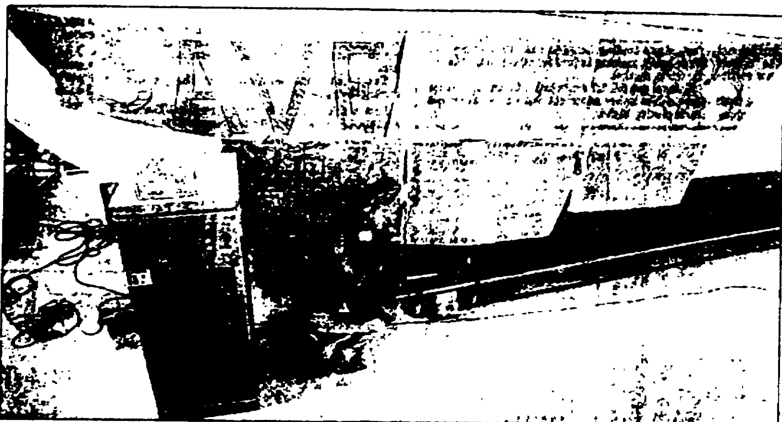
Nocenti said the industry's two and a half year recession and the Middle East war shared part of the blame for the move. However, he said, the recently enacted 10-percent luxury tax on new boats priced at more than $100,000 has dramatically reduced sales of boats in that price range, which accounts for roughly 70 percent of the company's product line.

"We're experiencing fairly good demand for mid-size models, particularly our 33- and 34-footers," Nocenti said. "But when you get to anything priced over $150,000 people aren't interested. That's when the (luxury) tax really begins to hurt."

Nocenti said dealer orders for Carver and Californian boats in the over-36-foot range will be filled from existing inventory.

Carver opened the Rocky Mount plant in January 1988. It employed more than 600 workers by mid-1988, Nocenti said. Carver moved production of all Californian models to the Rocky Mount plant in 1989 after closing Californian's Tustin, Calif., headquarters operation.

Nocenti said Carver's Pulaski facility employs about 630 workers, down from a peak of 1,312 in October 1988. ■



Courier-Post photos by Ron Karafin

Endangered species: Boatbuilder Vincent DeLucca (top) adds his name to a petition protesting a proposed 10 percent tax on luxury items, like boats built at the Jersey Yacht Company in Lumberton. Joseph Palecki (below), production supervisor at Jersey Yacht, says some New Jersey boatbuilders have been forced to shut down or cut back work forces

Tax could sink yacht builders

By BERNIE WEISENFELD
Courier-Post Staff

South Jersey boatbuilders, their sales already sinking in a weak economy, are trying to scuttle a proposed luxury tax on yachts.

The boatbuilders have been lobbying their senators and congressman in recent days, urging them to vote against President Bush's $500 billion deficit-reduction package. The plan includes a 10 percent tax on pleasure boats costing more than $100,000

"Jobs are scarce right now and that tax is ridiculous," Vincent DeLucca, an employee at Jersey Yacht Co. in Lumberton, said yesterday.

"I don't like it at all," said DeLucca, signing his name to a "Save Our Jobs" poster on the side of a boat hull. DeLucca also registered his opposition yesterday with a phone call to the office of U.S. Sen. Frank Lautenberg, D-N.J.

"If it does go through, it puts me out of a job," said DeLucca, a Voorhees parent of three teenagers.

The proposed luxury tax could end 8,000 jobs at boatyards nationwide, says the National Marine Manufacturers Association. The potential toll in lost sales: $350 million, the group says.

"They're trying to get more money from the rich, but we're poor guys building this stuff for a living," said Zygmont Niedzialek of Hainesport, a 20-year employee at Jersey-Yacht.

"It's terrible," said Felix Colon, hired just five weeks ago "I live in Camden where we don't find many jobs," he said.

Viking Yacht Co. of New Gretna, Burlington County, also is fighting the proposed tax.

"We've had several petitions, and we've distributed phone lists (of congressmen) to all employees, urging them to make calls on how their jobs will be affected," said Andrew Davala, a spokesman for the Burlington County boatyard

The luxury tax "would affect 100 percent of our product," he said. Viking's 38- to 58-foot yachts sell for $250,000 to $1 million.

The luxury tax would worsen poor conditions for the boatbuilding industry, boatbuilders said.

Jersey Yacht laid off 10 workers last week because of declining sales, a spokesman said. Viking, also hit by a sales slump, currently has about 300 workers, down from 730 employees in 1987-88.

"The boating industry has been down for the last two years," said Joseph Palecki, production supervisor at Jersey Yacht. He blamed an economic slowdown and the nation's thrift crisis, which has choked off dealer financing for new boat inventories.

More recently, rising gas prices and New Jersey's increased sales tax have hurt business, he said

"Bigger companies here in New Jersey have already shut down for a period of time," Palecki said. Others have laid off 50 to 75 percent of their work force, he added. New Jersey is a major boatbuilding state, with about 12 companies in the business, he said.

"Balancing the budget is not what we're voting against," said Palecki. Rather, "they ought to take a look at some of these taxes and make it more equitable," he said.

COVER STORY

Luxury levy isn't just taxing the rich

By Gregory Spears

[illegible]

■ *'It's just affecting an awful lot of people that Congress didn't intend to hurt,' says E. Clay Shaw, R-Fort Lauderdale. 'Congress forgot that Middle Americans are putting together the toys for rich people to buy.'*

Congress said it was sticking it to the rich when it imposed a 10 percent luxury tax on yachts costing more than $100,000.

[illegible] the new tax didn't hurt Donald Trump, but it [illegible] Arnold White, a 30-year-old [illegible] from St. Petersburg who lost his job selling 45,000-pound [illegible] million-dollar motor yachts.

"[illegible] a lot of people [illegible] compared that luxury tax [illegible]," says White, 30, who moved in with his mother and has been unemployed since [illegible]. "It killed the company."

White was one of 700 people thrown out of work when Viking Yacht Co. closed its St. Petersburg plant, which made live-aboard cruisers priced from $500,000 to $1.6 million, to consolidate operations at its headquarters plant in New Gretna, N.J.

The same day that White and his coworkers emptied their lockers, President Bush signed the $500 billion deficit reduction bill that included a 10 percent luxury tax on boats costing more than $100,000.

But the law has a flaw, according to Viking Yacht Co. Chairman Robert T. Healey that's killing some of the highly specialized businesses that build big-buck boats. The tax doesn't apply to used yachts.

[illegible], THE NEWS

Or as Healey likes to put it: a boat buyer now has to pay 10 percent more to buy a boat from him but not a penny extra for the Trump Princess. Trump's 282-foot seagoing status symbol is for sale at a reported price of $115 million.

The boat manufacturers aren't blaming the law for putting them out of business.

"Boats are purchased with discretionary income," said Frank Herhold, director of the Marine Industries Association of South Florida. "We were first hit when the recession started, and the timing couldn't be worse. The concept was to tax the rich."

The luxury tax "makes it tremendously more attractive to buy a second-hand boat, which means more and more unemployment in the boating industry," said E. Clay Shaw, R-Fort Lauderdale. Shaw is heading an effort to repeal the luxury tax on yachts.

"It's just affecting an awful lot of people that Congress didn't intend to hurt," Shaw said. "Congress forgot that Middle Americans are putting together the toys for rich people to buy."

Shaw said the tax is costing jobs in Florida, which has 600 boat building companies, more than any other state in the nation.

In 1990, 5,000 of the state's 18,800 boat builders lost their jobs, according to state figures.

In December, Burger Boat Building in Lantana suspended operations, idling 185 workers who had built big yachts at the company's shipyard.

Donzi Marine moth balled its boat-building plant in Tallevast last fall, where about 100 workers were employed. Most of them relocated to the company's Swansboro, N.C., plant, according to company president Gordon Houser.

"To tax an industry that's on its knees doesn't make any sense to me," said Houser. "It seems that whenever there needs to be a tax, the federal government or the state government thinks that anyone who owns a boat is a fat cat."

Boating industry analysts say the recession and higher fuel prices played a major role in job losses. Nationally, boat sales were off 42 percent before the luxury tax was imposed, according to the Marine Manufacturers Association.

But the luxury tax was the "coupe de grace" for a distressed industry, Healey contends. Business was grim at the New York and Miami boat shows this year, traditionally bellwether events.

He said Viking didn't sell one boat, and it usually takes orders on a dozen or more at the shows.

Despite the boat building industry's problems, Shaw doesn't expect Congress to repeal the luxury tax this year.

As Pat Jones, spokesman for the tax writing House Ways and Means Committee put it this week, "I have a tough time feeling sorry for people in the business of selling million dollar yachts.

"The assumption up here was that people who were buying luxury items really don't care what they pay," Jones said. "I mean, who would pay $50 for a box of chocolates when you can buy a Hershey bar? Those people have so much money that this luxury tax is not going to make any difference."

It's that kind of talk that makes Healey furious.

He contends that Congress made no effort to understand the boat building industry before it passed the tax. He contends the luxury tax on boats was not enacted for the money — just $3 million — but as a potent political symbol in last fall's election that Congress was intent upon taxing the rich.

But the rich didn't get wealthy by overpaying for big ticket items, Healey contends. Thanks to durable fiberglass hulls and long-lived diesel engines, the used yacht market is full of tip-top ships that can be bought for less than new boats, he said.

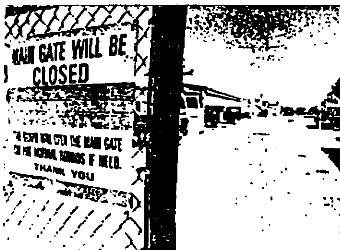
And many big-boat makers can't withstand any more bad weather.

"What they didn't understand in Washington is that the little guys — the entrepreneurs — build the big boats. And the big guys — Outboard Marine Corp and Brunswick Corp. — make the little boats," Healey said.

So instead of prying open Donald Trump's wallet, Healey said the new tax has succeeded in throwing a lot of guys like Arnold White out of work.

White, meanwhile, is worried about his mother, Shirley, a 13-year Viking employee. She will work her last day when Viking's commissioning yard — where boats are put in the water and made ready for their owners — closes March 15.

"She's 56 and I don't think she'll get another job," said her son. "She's the one I'm really worried about." ❑



[illegible], THE NEWS

SHUT DOWN: In December, Burger Boat Building in Lantana suspended operations, idling 185 workers who had built big yachts at the company's shipyard.

What the law does

■ The $500 billion deficit reduction bill includes a 10 percent luxury tax on furs, jewelry, cars costing more than $30,000.

■ The tax took effect Jan. 1 and also applies to cost of the boat over $100,000.

■ A $150,000 boat costs $5,000 more now; a $1 million yacht $90,000 more.

■ The government expects to collect $3 million from the tax this year.

New luxury tax protested by Maine boatbuilders

● Many say they have had to lay off workers because the tax has brought about a decline in boat orders.

By CLARKE CANFIELD
Staff Writer

Maine boatbuilders are protesting a new federal boat luxury tax that they say has further depressed their industry

Their concerns come as the nation's largest boatbuilding trade organization campaigns to have the tax repealed The 10 percent federal tax, passed by Congress last fall as part of the overall budget, is applied to the portion of retail prices that exceeds $100,000 on new boats sold in the United States

Boatbuilders, already struggling from a sluggish economy, say they have had to lay off workers because of a decline in boat orders brought on by the new tax They say that once people learned of the tax, they stopped ordering high priced boats

Hank Halsted, of the Hinckley Co boatbuilding firm in Southwest Harbor, said the law was designed to get money from the rich, but instead will hurt the working men and women who lose jobs because of it.

"This tax just turns off the spigot on the American boatbuilder in an arbitrary way," said Halsted, whose company sells 15-18 boats a year in the $350,000 to $1 4 million price range. "That's what this law is all about."

There are dozens of boatbuilders along the Maine coast, some of which build scores of boats a year, others which make only one or two to stay in business.

Exact figures are not available, but it is estimated there are about 100 boats built in Maine each year with pricetags of more than $100,000 Each boat order can employ many workers for months at a time.

Halsted said he knows of four boat orders his company has lost for 1991 because of the new tax, lost orders that have resulted in five or six workers being laid off

Philip Bennett, sales manager at Hinckley, said the poor economy has had a major impact on the boatbuilding industry, and the tax could be the fatal blow for some firms

"How much you blame on the economy and how much you blame on the new tax, who knows?" he said. "But it sure doesn't help"

The National Marine Manufacturers Association, a 1,700-member organization based in Chicago, estimated that 6,000 8,000 jobs will be lost in the boatbuilding industry nationwide because of the new tax.

Association spokesman Gregory Proteau said the government will lose income taxes from the wages of laid-off workers, and could end up paying them welfare In the end, he predicted the government will lose as much money as it will collect in new taxes

"It'll be a wash," he said. "To us, this is purely a jobs issue"

The association will spearhead a campaign to have the tax repealed when Congress convenes this month In the meantime, Maine boatbuilders have started a letter-writing campaign to the state's Congressional delegation, urging it to help repeal the tax

In a recent letter to Sen George J Mitchell, Timothy Hodgdon, president of Hodgdon Yachts Inc in Boothbay Harbor, wrote that many boatbuilders will go out of business in the next year, tax or no tax

"But the tax will assuredly add to this situation and hasten the demise of some of us who would have made it," he wrote

Christopher Evans, vice president of Sabre Yachts in South Casco, said if luxury items are to be taxed extra, the taxes should apply to more than just expensive cars, boats and airplanes Sabre Yachts has not lost any orders or had to lay off any workers because of the tax.

"We support (the campaign to have the tax repealed) because it's an unfairly aimed tax," Evans said

James Chandler, director of the Maine Marine Trade Association, said the tax has elicited more concern among the state's boatbuilders than any other issue in recent memory

"It's a double whammy with the poor economy, and now a luxury tax," Chandler said

William Scherr, manager of DiMillo's Marina and head of the Wharf Owners and Marina Operators Association, feels the industry is being unfairly picked on by the imposition of a new federal fee on most saltwater boats

Silverton lays off 30 more workers

By CHERYL WHEATON
Staff Writer

Silverton Marine Corporation announced plans Friday to slow its production rate and cut 30 workers, its third round of layoffs since September.

Citing increasing recessionary pressures, a "discriminatory" excise tax and the Middle East crisis, Silverton executives said in a statement that it's time for a more cautious approach to business.

"By taking a conservative approach right now, we are bracing for the worst and hoping for the best," said Michael Murawski, Silverton vice president and general manager.

Murawski said Silverton is reducing its staff by about 30 employees from all levels and departments. Under company policy, the furloughed workers will be notified by Jan. 18 and their last day of work will be Feb. 1, he said.

On two separate dates during September, the company laid off

Please see *Silverton, page 2-A

From page one

*Silverton

about 60 people. Coupled with Friday's announced cutback, Silverton's work force has dwindled to 120 employees.

"We have every intention to get the people back as soon as possible," Murawski said. "With the Middle East thing, we can't tell what the future may hold. I will make a committment to get them back as soon as possible."

The decision to postpone the production consolidation of Mainship, Silverton's sister company, was another contributing factor to the staff cutback, he said.

Mainship, which manufactures a contemporary line of power boats that range from 35 to 41 feet, has been working out of Marlboro, but plans were announced during the fourth quarter of 1990 to move and consolidate production to Millville.

Given the uncertainties of the current contracting market, all such plans were put on hold, according to Murawski.

"What we are seeing on the sales end is that many would-be buyers are worried and waiting for a resolution to the Mideast crisis," Murawski said. "Couple this with the recession spreading to different economic groups and geographic areas and the recently introduced excise tax, it doesn't paint a very promising picture for short-term demand."

When the dust settled from the federal government's budget deficit battle, recreational boating had fallen victim to new "user fees" and an excise tax on new yachts. A ten percent tax is levied on any part of the retail price that exceeds $100,000.

The National Manufacturers Association, which represents approximately 1,800 boat builders nationwide, has fought the excise tax from the beginning, Murawski said.

The NMA has estimated that approximately 100,000 jobs within the industry have already been lost and that the new tax could lead to another 20 percent decline in overall sales with thousands of jobs lost in the process, according to Murawski.

THE SUN
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Boating industry struggles to keep head above water in hard economic times

By Peter Jensen
Anne Arundel Bureau of The Sun

ANNAPOLIS — Thanks to the protection of federal bankruptcy court, Roger R. Ramsey was spared the ignominious chore of watching an auctioneer sell his marina to the highest bidder tomorrow.

As it is, the Annapolis auction house will stay busy on the last day of 1990. Another foreclosed marina, Spa Creek Yacht Club in Eastport, is set to be auctioned in front of the Anne Arundel County Courthouse at 10 a.m.

In the booming economy of the mid-1980s, the prospect that two valuable marinas would be auctioned off in a single day would have been about as likely as a tidal wave on the Chesapeake Bay. But in the midst of what one boating industry veteran calls an "economic depression," it's just another day on the waterfront.

"As an industry, we overbuilt, we oversold, and we over-financed," said Mr. Ramsey, the owner of Berlitz Marina in Deale, who filed for bankruptcy shortly before Christmas. "A lot of people are contemplating doing what we've already done."

The Marine Trades Association of Maryland, the group that represents more than 1,200 businesses in the state's $1 billion boating industry, estimates that at least 26 of its members have gone belly up over the past year.

The National Marine Manufacturers Association in Chicago estimates that sales of new boats have dropped more than 40 percent from a year high — at a cost of tens of thousands of jobs.

Even the government has felt the pinch as revenues from boat excise taxes, licensing fees and marina fuel taxes have fallen dramatically.

"We know there'll be a lot more businesses closing in the next six months," said Mick Blackistone, executive director of the Annapolis-based trade group. "Forget recession. I'd call that an economic depression."

Nowhere is that more evident than in Annapolis, the self-proclaimed world sailing capital, where boat dealers, marinas and the companies that equip pleasure craft with everything from sails to sonars are numerous.

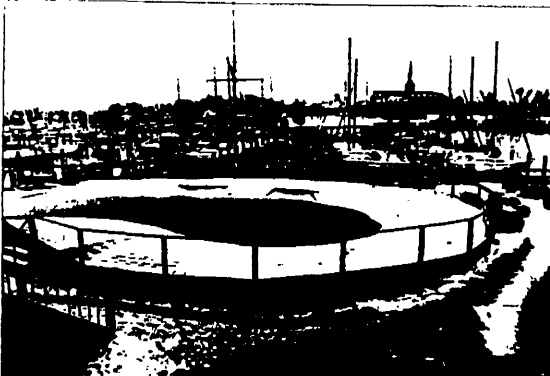
Until recently, many of those companies were considered to be relatively safe from economic turmoil, protected by their proximity to "recession-proof" Baltimore-Washington market.

But at Annapolis Yacht Sales, income is down 11 percent from 1989, according to the company's owner. At nearby Inter Yacht, a yacht brokerage firm, the company has survived a "year of treading water" while many of its neighbors have suffered far worse, said owner Alan Hamerstrom.

"Let's just say this is not the year I'm going to make my fortune," Mr. Hamerstrom said.

John Burgreen, owner of Annapolis Yacht Sales, said overall sales have been down only slightly from last year but that the drop in income has been substantial. Competitive pricing, sales incentives and a consumer preference for used boats caused much of the decline, he said.

"We always said, 'Boy, if I had the money, I'd buy a marina.' " Mr. Burgreen said. "Now look at it. On a scale of 10, I'd say we're at a 4½. Depression is a very good word for it."



Spa Creek Yacht Club in Eastport is scheduled to be sold at auction tomorrow.

Industry observers say the downturn really started two years ago, when concern over the federal deficit and a slowing economy caused increasing consumer caution about big-ticket purchases.

Since then, the likelihood of a worsening recession, the possibility of war in the Persian Gulf and a new federal tax on pleasure boats have only worsened the situation.

Beginning Tuesday, buyers of new boats face a 10 percent federal tax on purchases over $100,000, a measure approved by Congress to help trim the federal deficit.

The Linowes Commission, appointed by Gov. William Donald Schaefer to review the state's tax structure, has recommended a 2 percent personal property tax that would be applied to boats.

Though the state commission's findings have not been introduced to the General Assembly, even public debate over them has dampened consumer enthusiasm for buying boats, Mr Blackistone said.

"The mere mention of putting taxes on something gives people second thoughts," Mr Burgreen agreed.

Perhaps the best measure of the hard times facing the industry is kept by the state Department of Natural Resources. The DNR's Boating Administration collects a 5 percent excise tax whenever a boat is sold. The tax is the primary source of revenue for its Waterway Improvement Fund, which pays for such things as new boat ramps, buoys and dredging projects.

In fiscal 1988, the fund collected about $23 million. By next June 30, the end of the current budget year the fund will have collected an estimated $13 million, a 43 percent drop over three years, said Patricia E. Shanahan, a spokeswoman.

Mr. Ramsey, who has owned the 78-slip Berlitz Marina for 13 years, doesn't need to hear the statistics to see the trend. In the fall of 1988, he watched his boat sales begin to slip and even customers who already owned boats began taking them out of dry storage less frequently.

"We could have weathered a 10 or 15 percent drop in sales, but a 50 percent downturn killed us," he said.

Mr. Ramsey had a $1 million inventory of expensive powerboats and little money to make mortgage payments, so Annapolis Federal Savings Bank foreclosed. Mr. Ramsey said he sought bankruptcy protection to either restructure his financing or find a buyer for the 44-year-old marina.

Still, there is hope in the industry. Businesses that once specialized in new-boat sales are increasingly turning toward the used-boat market, and companies that repair boats are expected to do well in 1991.

"Some people think this may just be a purge for the industry, a leveling off back to reality," Mr. Blackistone said. "I guess we all hope that's the case."

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Boat-makers hoping roughest seas past

By ELAINE ROSE
Staff Writer

Southern New Jersey's boat manufacturers expect to be sailing some rough waters in 1991, but hope that new models and expanding foreign markets will keep their ships afloat.

Sluggish sales over the past two years have forced many companies to lay off workers, but representatives say the worst is over — unless the bank crisis deepens or the war in the Persian Gulf persists.

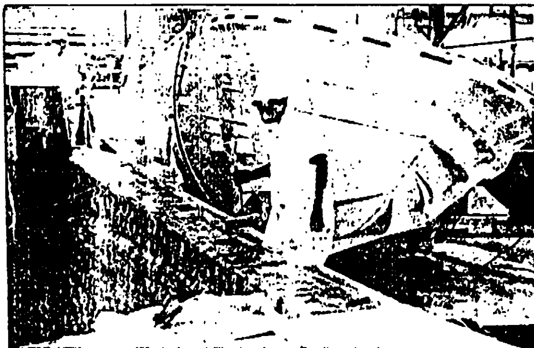
In 1989, about 1,100 people were employed in boat manufacturing in Atlantic, Cape May, and Cumberland counties, and that number will probably decrease by at le[ast] one-fourth by the end of 1[991], said Joanna Krahn of the Marine Trade Association of New Jersey.

Small boat sales went up about 25 percent in 1990, as manufacturers put together packages of 16 to 22-foot craft with motor, trailer, and accessories priced in the $5,000-6,000 range, Krahn said.

"There's definitely an increase in family boating. The state has recognized this and put in more launch ramps," she said.

Concentrating on family boaters and "giving more boat for the dollar than anyone else out there" is the way Silverton Marine Corporation of Millville hopes to weather the storm, said Vice President Mi-

See Boats, Page 15



Press photo by Rich Kolancha

Workers apply resin to boats in various stages of completion at Viking Yachts in New Gretna

Boats:

Manufacturers expect roughest seas are past

(Continued from Page 14)

chael Murawski.

The company laid off about 90 workers last year, but does not expect any more work force reductions in 1991, Murawski said.

Silverton is now concentrating smaller boats in the 28 to 34 foot range, and expects about 80 percent of its customers to come back in several years when they are ready to upgrade, Murawski said.

But boats are not considered necessities, "and when there's psychological concern in the marketplace, the money is not spent on discretionary items," said David Broome, vice president of the National Marine Manufacturers Association.

A recently enacted 10 percent federal luxury tax on items costing more than $100,000 is expected to cost about 8,000 American jobs this year in an industry that has already been beset by layoffs, Broome said.

"With the amount of taxes the government is going to raise versus the boats that won't be sold and the people who will be laid off, the tax will be revenue neutral or negative," said John Leek III, president of Ocean Yachts of Mullica Township.

Ocean Yachts expects to see another 20 percent decline in sales this year with the new tax "and war hanging over our heads," Leek said. The company employs about 155 people, down from a high of 290 two years ago, he said.

Most southern New Jersey boat manufacturers buy parts from area distributors, who are also hurting in the slump, Leek said.

Ocean Yachts hopes to offset sales losses with the introduction of new models and an increasing foreign market, Leek said. Two years ago, the company had no overseas sales, but hopes about 20 percent of the craft leaving the plant this year will go to foreign ports, he said.

European and Japanese markets are also a bright spot on the horizon for Viking Yacht Company, said Executive Vice President Thomas Carroll. Foreign sales accounted for about 3 percent of the company's total two years ago, jumped to 17 percent in 1990, and executives hope to send 25 percent of its boats overseas in 1991, Carroll said.

"In Europe and the Orient (Viking) is perceived as the best yacht in the world. This is analogous to the Rolls Royce and Mercedes of boating," he said.

But a prolonged war in the Middle East and resulting soaring fuel prices could put a damper on those projections, Carroll said.

The company is not setting its production schedules as far ahead as it did during better times, but if foreign sales figures remain steady, some of the 208 employees who were laid off in September may be called back to work, Carroll said. The company recently decided to close its St. Petersburg, Fla., plant and consolidate operations in the New Gretna facility.

Dealer inventory is at a three-year low, so any new sales will result in production orders, said Kenneth Jensen, vice president of Post Marine in Mays Landing.

"There's no question about it, the industry is in a downturn," Jensen said. "We certainly hope we're as low as we're going to go."

Boating Industry Snapshot

- In 1989, about 1,100 people were employed in boat manufacturing in Atlantic, Cape May, and Cumberland counties; that number will probably decrease by at least one-fourth by the end of this year.
- Small boat sales went up about 25 percent in 1990.
- Silverton Marine Corporation of Millville laid off about 90 workers last year, but does not expect any more work force reductions this year.
- The new 10 percent federal luxury tax on items costing more than $100,000 is expected to cost about 8,000 American boat industry jobs this year.

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Boatmakers take on water

MORE ON PROBLEMS BLAMED ON THE TAX [illegible]

By Gregory Spears
News Washington Bureau

When President Bush and Congress struck a budget deal late last year, one of the most-publicized facets was its "tax-the-rich" provision.

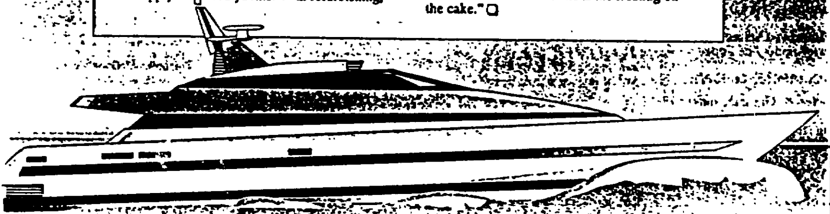
The $500 billion deficit reduction bill taxes people at the hefty rate of 10 percent for furs, expensive cars and yachts that exceed a set price limit.

Nobody wants a used fur and few people would buy a second-hand Mercedes if they can afford a new one, but boat builders say they are feeling the pinch from the large supply of used yachts. With refurbishing, a new luxury boat can last for years.

Congressman E. Clay Shaw, R-Fort Lauderdale, said the tax is costing jobs in Florida, which has 600 boat-building companies - more than any other state in the nation. In 1990, 5,000 of the state's 18,800 boat builders lost their jobs, according to state figures.

One of the hardest hit is Burger Boat Building's Lantana plant, which suspended its South Florida operations in December. Almost 200 people were laid off.

"Nobody blames the luxury tax for all the problems we're facing," said Frank Herbold, director of the Marine Industries Association of South Florida. "But this is the frosting on the cake."



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Luxury boat tax seen as threat by boatbuilders

By DONALD WITTKOWSKI
Staff Writer

A new luxury tax on expensive boats, a result of a soak-the-rich sentiment embraced by Congress this election year, threatens boat manufacturers already sinking in a sea of red ink, industry officials say

The 10 percent surcharge on new boats costing more than $100,000 is among the tax provisions in the federal budget approved last month by a bitterly divided Congress and now awaiting President Bush's promised signature

The levy will be imposed on that portion of the price above $100,000, meaning the buyer of a $200,000 boat, for example, will face a luxury tax of $10,000

Although middle-class America might not care that those wealthy enough to afford expensive pleasure craft will be hit harder, boatbuilders and retailers are predicting the tax

See Boats, Page A4

Press photo by Ben Fogueno

John Rotelle Jr., owner of Cape Island Yacht, predicts some retailers will fail this winter

Boats:

Luxury tax bad news for boatbuilders

(Continued from Page A1)

will devastate the industry.

However, there may be a buying spurt from now until the tax takes effect on Jan. 1 as boaters rush to save money, officials said Later on, production and sales are expected to plummet.

"The first quarter of next year will be dead," said John E. Leek III, president of Ocean Yachts Inc in Mullica Township, which manufactures boats ranging in price from $100,000 to $1 million.

"As bad as the boat business has been — we're down now 40 to 50 percent — we may go down another 40 to 50 percent," said John Rotelle Jr, owner of Cape Island Yacht Sales & Marina in Somers Point, whose boats sell for $100,000 and up

"It will be very difficult. I think a lot of retailers won't make it through the winter," Rotelle said

The boating industry already is in the midst of hard times due to the recession in the Northeast, the savings and loan crisis that has tightened credit, and overproduction by manufacturers.

"The marine retail industry probably is in its worst slump in the last two decades," said Phil Keeter, executive director of the Marine Retailers Association, a national lobby representing 4,000 boating retailers

Soaring fuel prices brought about by tensions in the oil-rich Persian Gulf region following Iraq's invasion of Kuwait in August have further depressed the market.

Boatbuilders have been laying off workers and cutting back on production to avoid going under. The luxury tax will result in the loss of 8,000 more jobs in the next two years, according to the National Marine Manufacturers Association, the boatbuilders' national lobby

"There has been a lot of nervousness brought on by the luxury tax," said Robert A. Hazard, national marketing manager for Egg Harbor Yacht Co in Egg Harbor City "It's not helping us at all"

Egg Harbor Yacht has slashed its work force by 90 percent and cut production to two boats a month, down from a peak of 120 boats a year Its boats range in price from $150,000 to $1 million

Egg Harbor City Mayor James E. McGeary, noting the firm's plight and the difficulties of other boatbuilders in southern New Jersey, wrote to Bush last month urging him to reject the luxury tax.

U S Rep. William J. Hughes, D 2nd, voted against the budget, in part, because of the expected harm the tax will have on boat manufacturers.

Hughes, whose district includes much of the New Jersey shore, also objected because the budget includes what he said are unwarranted new user fees on all boaters plying waters patrolled by the U S Coast Guard

Marine officials also noted that the budget imposes a 5-cents-a gallon increase in the federal gasoline tax, another expense expected to hurt the boating industry

Although the boatbuilders have complained of being singled out by Congress, the budget also calls for a 10 percent luxury tax on expensive planes, cars, jewelry and furs to raise revenue to help offset the federal deficit.

"We were basically held up as a sacrificial lamb" Leek said of the boat manufacturers

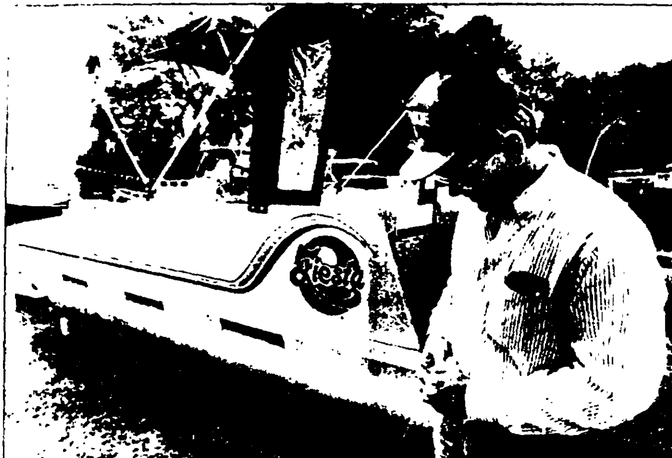
Hughes tried unsuccessfully to convince the House Ways and Means Committee and the House Democratic Caucus to push through a compromise to have the luxury tax also apply to the sale of used boats

Under Hughes' plan which was supported by the boating lobby, there would have been a 5 percent surcharge for both new and used boats costing more than $100,000 That would have softened the residual effect on boat builders, said Hughes' aide Mark Brown

Now with the 10 percent tax a certainty, manufacturers have begun searching for ways to overcome the predicted adverse impact on business

For instance, Viking Yacht Co in New Gretna, builder of boats ranging in price from $250,000 to $2 million, will concentrate more on the international market in an effort to double its sales in Europe and Japan, said Andrew Davala, the company's director of personnel

"We're hoping there may be some way to compensate for the luxury tax," he said



Tony Ranze/The Ledger

Randy Kincaid prepares for an auction at Jungle Jim's Marine in Lakeland.

Boat industry hits rough seas

By Michael Peltier
The Ledger

LAKELAND — Randy Kincaid, who has weathered the past three years in a slumping boat industry, is calling it quits today

Kincaid owner of Jungle Jim's Marine on U S 92 is auctioning off his inventory and turning his attention to a growing auction business

It was bad last month and the month before," Kincaid said earlier this week But it got worse this month "

There is nothing happening. I'm liquidating all my inventory I've had a lot of interest in that but as far as being able to sell merchandise at regular price — Man, no way "

Kincaid is not alone Sales of motorboats, yachts, marine parts and accessories in Polk County were off 45 percent in October from a year ago, the state Department of Revenue said in its most recent report Sales, which totaled $1 8 million in Oct 1989, plunged to $1 million in October 1990

There is a lot of apprehension in the market because of the fear of gas prices " Kincaid said "That is one of the things that is most depressing. On top of that is the uncertainty of where we're headed in terms of energy costs "

Nationally, recreational boating was a $14 billion business in 1990, according to the National Marine Manufacturers Association, a 7,000-member industry trade group Revenues for 1990 were down 22 percent from a record of $17 9 billion set in 1889

Higher fuel prices, a weakened economy and a new 10-percent luxury tax on boats costing more than $100,000 have combined to put the bite on boats, discretionary purchases that are the first to go when purse strings are pulled tight

"The boating industry as a whole has been soft for the past three years," said Ed Coker, owner of Coker Marine in Lakeland "But it's one of those things that is coming back "

Dealers are not the only ones affected by sliding boat sales Many boat plants have been shut down, said National Marine Association's president, Jeff Napier "If we don't have a strong spring selling season, a lot more will go down," he said

Kincaid, who became a registered auctioneer last year, said the he is negotiating with a two Florida-based boat man-

► See BOATING, page 6E

Boating industry

► Continued from 1E

ufacturers to liquidate whole plants.

Polk County may be insulated somewhat from the national slump, because most dealers run smaller, less expensive operations that can weather sluggish sales more readily, Coker said

"All your major dealers, are folding up right and left," Coker said "Their sales are down so much that they can't meet their overhead and so they're just shutting their doors. Smaller, independent dealers are still doing well."

Coker said that his business is up about 8 percent over last year

Kincaid said that it may take a year to see boat sales back on track

"It's not all dismal, Polk County is probably faring better than a lot of places but it's going to be off for a year before it comes back," Kincaid said

This article contains information from the Associated Press.

ARKANSAS GAZETTE

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Recession taking heavy toll on boat makers, retailers

BY JANELL BLOUNT
Democrat Business Writer

Arkansas boat manufacturers and retailers are feeling the bite of recession and facing the dark side of the industry's economic cycle.

According to information from the National Marine Manufacturers Association, new boat sales nationwide fell 21 percent in 1990 from 637,500 in 1989 to 504,100 last year.

The association, which has about 1,700 members nationwide and 15 in Arkansas, indicated the industry operates in 5- to 10-year cycles.

Since 1988, "decreased new boat sales have been attributed to declining consumer confidence in the economy, increased interest rates followed by restrictive credit growth" and the situation in the Middle East, the NMMA reported.

Ranger Boats in Flippin recently laid off 75 people because of the economic crunch, according to Randy Hopper, president of the fiberglass fishing boat firm.

War affecting industry

While the decrease in boat sales has hurt manufacturers like Ranger, recreational boat makers are not alone. War in the gulf also has affected commercial boat manufacturers, including SeaArk Marine Inc. in Monticello (Drew County).

John Smith, vice president of sales and marketing for SeaArk, said the company's defense-related business and oil industry related business "are hitting us both ways."

Smith said SeaArk plans to lay off part of its approximately 100-employee workforce this week, but said he didn't know how many workers will be affected.

Planned government funding has been tabled due to the war, Smith said, adding that business may be bolstered when the tide in the gulf war turns. Currently, Smith said, SeaArk is watching government and industry oil spill response movement as a potential positive factor.

Tax in works

Greg Proteau, a spokesman for the NMMA, said Monday the federal excise tax on $100,000-plus boats may not have an immediate effect on smaller boat makers and retailers, but that another tax may be on the way. "The foot's in the door," he said.

"When the government realizes it's not making money on this tax, it will try to broaden the base. The tax will most impact the thousands of technicians, mechanics craftspeople, salespersons, office and other wokers whose livelihoods go into building" the yachts and cabin cruisers that will be taxed. "Job loss in the boating industry has already topped 100,000 due to a 40 percent drop in sales over the past two years." The association expects the excise tax to cost the industry another 8,000 jobs.

The recreational marine industry in Arkansas employed an estimated 6,377 people in 1989, according to the NMMA.

Retailers like Art Eastham, owner/operator of Art's Marine and Sports Center in North Little Rock, said sales fell only slightly in 1990. While sales may fall, Arkansas retailers are aided by the fact that most of them sell small boats to a large fishing population during a longer-than-average fishing season.

User fee effects

Earl Milligan, owner of Milligan Bradford Marine in Hot Springs, said he sold no boats for more than $20,000 last year. "It's harder to sell the big boats," he said, adding he is anxious to see what effect the user fee on boats larger than 19 feet will have on sales.

Bernard Hargrove, owner of Red River Marine in Heber Springs, sells the so-called luxury boats, but said those sales account for less than 5 percent of his total sales. However sales of the higher-priced boats "have not been down."

"We've lost a lot of entry-level boat (purchases) due to the war situation," Hargrove said. Younger consumers "aren't in the market for boats at this time," and he said he feels the excise tax will "have little effect on those who can afford to spend money" on a more expensive craft.

As for the danger of a broader-based excise tax, Hargrove said attempts to lower the cut-off amount for the tax would meet with more opposition. "We didn't have the entire industry concerned" with the $100,000 figure.

"It's a great time to buy a boat under $100,000," Hopper said.

BRIDGETON NJ
NEWS

AP Laser Photo

Hans Mikaitis, a custom boat builder and owner of Master Shipwrights, Inc., of Keyport, poses on a 26-foot steam launch worth $100,000 he completed recently at his workshop. Mikaitis says business has never been slower in his 34 years as a custom shipwright.

N.J.'s boat industry facing tough year

By HENRY STERN
Associated Press Writer

New Jersey's boat industry faces an uncertain future as the recession and new luxury taxes combine to discourage prospective buyers. And the situation is made worse by boat owners, who are driving down prices by unloading their vessels.

Boat builders and boat sellers said Tuesday that the new year will likely continue a plunge that quickened last year with the recessionary economy.

That could mean more layoffs in an industry that has already lost hundreds of jobs.

"I've never seen anything like it," said Hans Mikitis, the owner of Master Shipwrights in Keyport. "It's just devastating. This past year has been the pits. I'm picking through stuff right now looking for business."

Mikitis, who has custom built boats for 34 years, said he has received a fraction of the inquiries this year that he did in the past. A few years ago, he employed 22 people; last year he had four, this year it's just him.

"I don't know how long I can wait for this to come around," he said.

Mikitis attributed his company's freefall to the poor economy, but dismissed the impact of higher gasoline prices. Larger manufacturers share Mikitis' evaluation of the past year and they sense gloom for the year ahead.

A federal luxury tax that began Jan. 1 was blamed by many for the bleak outlook. The 10 percent surcharge is applied to the portion of the price that exceeds $100,000. For example, the tax on a $500,000 boat would be levied on $400,000, for a total of $40,000.

The National Marine Manufacturers Association estimates the surcharge will cost 8,000 jobs over the next two years.

"I think it's going to be a very slow year for everybody," said Maria Henriques, the office manager of the 20-employee Henriques Boat Works in Berkeley Township. "There might be layoffs. We just don't know at this point. We just have to hang in there."

Henriques, whose company makes boats in the $146,000-$350,000 price range, said cash-strapped boat owners trying to sell their vessels have hammered down prices.

The savings and loan crisis also has contributed, drying up funds for anybody who might want to take out a loan to buy, Henriques said.

Ken Jensen, a vice president at Post Marine in Mays Landing, anticipated a 30 percent drop in business this year and said federal lawmakers should have been more sensitive to the industry's plight.

"People might have shrugged this tax off during a strong healthy economy," Jensen said.

The dozen or so boats made this year by Post Marine cost between $400,000 and $600,000. Jensen said he's laid people off, but he wouldn't say how many.

DAYMON J. HARTLEY/Detroit Free Press

Sea Ray employees leave the Oxford Township plant Tuesday. It will close for good Jan. 20.

PULLING UP ANCHOR

Oxford boat maker Sea Ray to leave home port when plant closes next year

BY [illegible]

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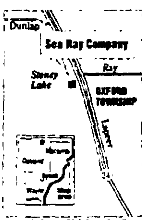
Sea Ray is a bit more glamorous than Oxford's previous claim to fame. At the turn of the century, it was regarded as the sand and gravel capital of the world.

"It's definitely sad," Rose Ann MacGuire, Oxford Township supervisor, said of the Sea Ray closing. "They've always been very good to the community and very supportive of the township."

The Oxford Township plant, established in 1962, is the oldest of Sea Ray's seven plants, including one in Cork, Ireland. Company officials blame sinking boat sales for the closing.

Nationally, boat sales dropped from a record 749,000 in 1988 to 637,000 in 1989. The National Marine Manufacturers' Association is expecting at least another 10 percent decline this year.

But many in Oxford see a



CATHY MORRIS/Detroit Free Press

different culprit, blaming the plant's closing on the huge impersonal conglomerate — Skokie, Ill.-based Brunswick Corp. — that bought Sea Ray for $350 million in 1986.

"Most of the days of its existence, all the officers were here and they set their own policies," said Bill Offer, a Sea Ray vice president from 1966 to 1970 and a former Oxford Township trustee and supervisor. "It was different than it is now. When you become part of a big company, they kind of take control."

As far back as the turn of the century, the family of Sea Ray founder C.N. Ray owned extensive gravel mining operations in the Oxford area, but Ray wanted to branch out and founded Sea Ray — naming it after himself — in 1959.

"From an early age, he had been around boats a lot," Offer said of Ray. "He got into boats and he did it right. He built a quality, well-designed boat, and he didn't over-franchise it. He kept the number of franchises down."

Sea Rays were among the first boats to exploit the potential of fiberglass. Hulls were designed by Sea Ray, but Ray hired automotive engineers to craft decks and interiors.

"He really made some innovative changes in fiberglass

See SEA RAY, Page 2G

Boat maker to close Oxford plant

SEA RAY, from Page 1G

boats, from the days when they used to pull those old speckled hulls out of the mold and dab a little white and black paint on them," Offer said.

Ray shifted Sea Ray's headquarters from Oxford to Knoxville, Tenn., in 1978, but the Oxford plant continued to flourish, reaching top employment of about 800 in the late 1970s, said Jim Steffins, the current general manager.

"We did build quality," said Steffins, 42, of Lake Orion, who began his Sea Ray career on the assembly line in 1967. "We stood behind our boats, if there was a problem with them. Maybe we stood behind them too much.

"We had a group of dealers in here a few years ago for a tour, and we had some of the early models on display, from back in the 1960s. They still looked like brand new."

When production ended at Thanksgiving, Oxford was making 22-to-27-footers, the same models made at the company's Phoenix plant.

"We had a great reputation for building a handcrafted boat," said George Stubblefield, 54, of Ortonville, who worked at Sea Ray for 15 years. "Sea Ray is not closing this plant because of our quality or the people here."

Stubblefield, who assembled boats, said company officials once asked him to take special care with a boat intended for a boat show.

"I said, 'Hell, all the boats we build are showboats . . . I'll do it just like any other boat.'"

Sea Ray has been a less close-knit operation since Brunswick took over, but making Sea Rays was good work, Stubblefield said. Assemblers earned between $10 and $10.50, which made hourly jobs at Sea Ray the highest paying between Pontiac and Flint, Stubblefield said.

"We were a family under Cornelius N. Ray . . . Under Connie Ray, I felt like I was George Stubblefield. Under Brunswick, I felt like I was a number," he said.

Most Sea Ray employees live within a 40-mile radius of Oxford, and Sea Ray is offering placement services for those who are losing their jobs. Officials expect little immediate financial impact on local businesses, because the work force comes from such a wide area, or on the township, which will continue to collect property taxes, said MacGuire, the township supervisor.

Nor do Oxford officials expect the plant to stay vacant for long. The 200,000-square-foot building is less than 10 miles from General Motors Corp.'s Buick-Oldsmobile-Cadillac Orion Assembly Center, which might make it attractive for automotive suppliers. The township has received several inquiries from possible buyers, MacGuire said.

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KNOXVILLE, TN
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KNOXVILLE METROPOLITAN AREA

Weathering the storm

Boat makers anxiously await economic upturn

By LAURA SIMMONS
News-Sentinel business writer

East Tennessee boat manufacturers are hanging tight during a prolonged wave of bad economic news.

At least one manufacturer, however, has washed out and another has started a new company hoping to catch the next wave up.

Boat makers are among the first to feel a downturn in the economy, industry experts say, and among the first to feel an upturn. As consumer confidence wanes, big ticket items like boats are quickly scratched off the shopping lists.

"One of the things we have found out is, we are probably one of the best economic indicators," said Scott Atchley, director of marketing for Cobia Boats in Vonore. "When we trip, everybody else falls down."

In 1990, retail expenditures on boating were $13.7 billion, down from $17.1 billion in 1989, according to the National Marine Manufacturers Association. The 20 percent drop in 1990 was preceded by another bad year in 1989, which saw a 15 percent decrease. The industry enjoyed robust sales in the mid-1980s until 1987.

After two bad years, some manufacturers said they were hoping to see a modest gain in 1991, but the Persian Gulf War quickly dashed those hopes.

"It looks like, because of the situation in the gulf and other economic things going on in the U.S., it will probably be another flat year," Atchley said.

Thunder Craft, a manufacturer in North Knox County, shut down its plant in October and has not resumed operations.

Sea Ray, East Tennessee's largest boat manufacturer, shut down for one week earlier this month and has mentioned the possibility of going to a four-day workweek to decrease inventory.

Joe Bryant started Bryant Boats Inc. last October in Sweetwater. The 12-employee company is made up primarily of family members.

"We see some opportunity in a down market," Bryant said. "We are able to come in, and we don't have an extremely high overhead, and we are keeping the costs as close to the vest as possible.

"We are able to pass that on to the dealer, and that makes us pretty competitive, actually," Bryant said.

"The marine market is headed for a real upturn in the near future," he added. "We feel like by positioning ourselves during a flat time, we'll catch the ride up."

Bryant said some of the larger manufacturers are partially to blame for their current difficulties.

"When the economy was booming and business was going great, the manufacturers, in my opinion, didn't keep close enough contact with their dealers. They should have listened a little more instead of building boats."

Supra Sports Inc. in Greenback announced last June it planned a public stock offering to raise capital for a plant expansion and other improvements.

"The public offering is going along as planned," said George Fowler, president and chief executive officer. "Because of the market conditions, it is a little slower than we had projected, but other than that, the original plan is intact and being played out. We are going to execute the plan; we are just letting the timetable slide a little."

Fowler said he thinks the boat market has bottomed out. "At what pace the recovery is, I think is yet to unfold."

Fowler said he has seen encouraging signs at this year's boat shows, and orders are up 15 to 20 percent from the same time last year.

"Even though we are having a better year, I don't think it's going to be bragging rights for anybody. As I see it, the pipeline still has excessive amounts of inventory in it."

The boat industry in the 1990s will be different from the 1980s, he said.

"I think in the '80s it took off at a high rate of speed," Fowler said. "The growth was probably an out-of-control situation. In the '90s, I think it will be a more controlled growth."

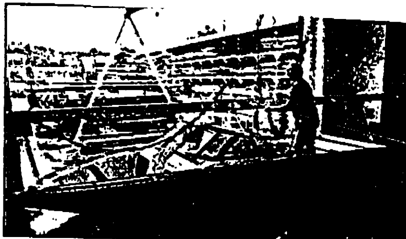
Thom Ris, director of corporate communications for U.S. Marine, which has two plants in Dandridge, said his company originally projected 1991 to be a year for gains.

"The boating industry has always led the economic picture," Ris said. "We were of the opinion until the 16th of January that it was going to be a very good year and things were going to improve."

Sales, however, have "hit the wall" since Operation Desert Storm began, he said. "Frankly, it's a day-to-day thing. We are watching it closely."

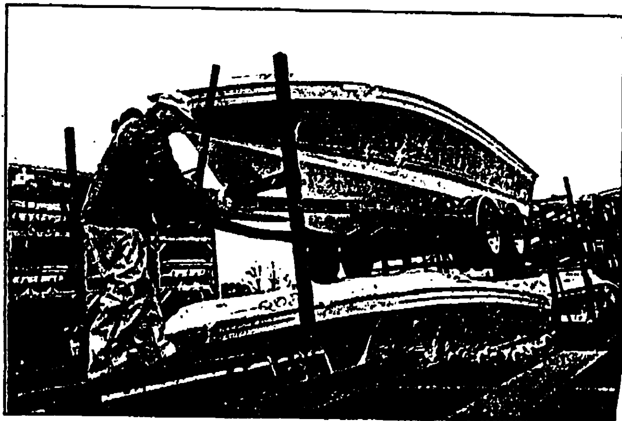
Employment at the two Dandridge plants is down from 250 in January 1990 to 161 this month.

Executives at Master Craft Boat Co. in Maryville were unavailable for comment. However, a spokeswoman said current employment is 223, down from 380 reported in January 1990.



Jack Kirkland/News-Sentinel staff

Doug Hipps of Supra Boats gives a boat the pool test before sending it on through the line at the company factory at Greenback.



Jack Kirkland/News-Sentinel staff

Freddy Starritt prepares a load of Supra Boats models for shipment to the West Coast

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BOAT SHOW LISTS UNDER TAX THREAT

By Cindy Harper-Evans

For many boat dealers, the United States Sailboat Show opening today in Annapolis will be a bittersweet affair

Looming over the City Dock and harbor, where dealers have gathered for 20 years to sail their stuff and woo potential buyers, is the fear of what a 10 percent tax on boats and yachts costing more than $100,000 would do to an already wayward marine industry.

Sunday, the 10 percent tax on so-called luxury items was included in a five-year budget plan aimed at easing the federal deficit. The plan still must be approved by Congress.

Dealers are expected to use the potential tax as a marketing tool at this weekend's show — the largest of its kind in the country — as they try to get the expensive boats out of their inventory before the tax takes affect.

Mick Blackistone, executive director of the Marine Trades Association of Maryland, said he hopes the boat show will "make something very positive for the short term out of something that is likely to have a devastating affect on the industry"

But industry observers acknowledge that the marketing ploy is indeed a very short-term solution to a problem that is likely to cost 8,000 jobs in the boating industry, which has already laid off one-sixth of its 600,000 employees because of a two-year sales slump, the National Marine Manufacturers Association in Chicago said.

Sales, according to the association, have tumbled 20 to 30 percent this year compared with 1989, when they were down 15 percent from the year before

Although boats costing more than $100,000 account for only 5 percent of sales, marine trade groups say that expensive boats require more man-hours because they are larger and heavier

"Canvas people are going to lose canvas jobs, paint people are going to lose paint jobs, and the list goes on and on," Mr Blackistone said

Many industry observers say the bulk of the $32 million a year the federal government expects to reap from the proposed luxury tax could be eaten up in unemployment benefits.

"The luxury tax coupled with the gas tax and the mini-recession — these three things are going to be the kiss of death for the marine industry," said Thomas Trainer, owner of McDaniel Yacht Basin Inc., which is based in North East.

"If the tax goes through, I don't know what people can do. Hopefully, people will adjust," said Jay LeBow, owner of Annapolis Sail Yard Ltd. "Some of the weaker builders are going to go under"

Some boat sellers said they probably will start pricing many $100,000 boats at $99,000 so that buyers can escape the tax.

Area dealers said they realize they can't rely on the assumption that people who can afford boats costing more than $100,000 don't care about a 10 percent tax on top of a 6 percent sales tax

"All of the sudden, the guys everyone says are rich are starting to think twice about buying a boat," said Gary Proteau of the National Marine Manufacturers Association.

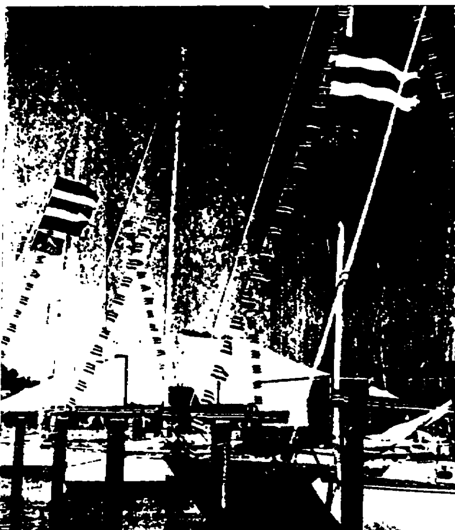
The effect of the slipping boating market can be seen in the number of exhibitors scheduled to appear at this year's show. Fewer than 200 boats will be on display, down from close to 300 last year, said Jeffrey Holland, spokesman for Annapolis Boat Shows Inc

Part of the reason is that many dealers have gone out of business and others don't want the expense of attending the show

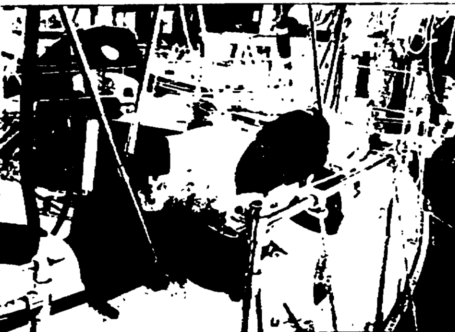
Nora Atkins, part owner of Atkins Yacht Sales in Annapolis, said her small boating business, with annual sales of about $500,000, opted out of the sailboat show this year.

"The recession is very, very real, and it's taking a toll first on high-ticket items," she said. "We're just focusing now on trying to weather the storm."

The show runs from 10 a.m to 7 p.m today through Sunday and 10 a.m. to 6 p.m. Monday. Admission is $8 for adults and $4 for children under 12.



THE SUN/WALTER M. McCARDELL JR



THE SUN/WALTER M. McCARDELL JR

Sailboat flags wave in the breeze (top) at Annapolis' City Dock, while Jim Hackett of Fort Myers Yacht and Shipbuilding in Florida polishes one of his company's boats.

BUSINESS

Luxury Tax Gives Builders of Yachts a Sinking Feeling

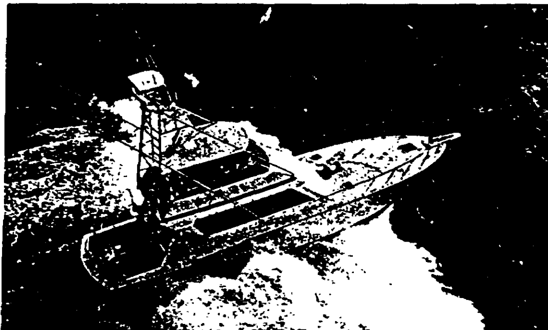
SUMMARY: The 10 percent luxury tax worked out by Congress and the Bush administration last fall was designed to boost revenues by taxing the rich. But yacht makers say the tax threatens their industry and actually may end up costing the government money. They maintain that it will destroy jobs and thereby hurt workingmen, not the wealthy.

In their alleged zeal to reduce the hemorrhaging federal budget deficit, Congress and the Bush administration have struck a crippling blow at a premier American industry: yacht building, one of the few areas where U.S. manufacturers still hold a commanding lead over foreign competitors.

On Jan. 1, a 10 percent luxury tax went into effect on yachts costing more than $100,000 as well as a handful of other high-ticket items. A child of the bipartisan budget accord reached last October, two weeks before the congressional elections, the luxury tax inherits the features of classic Washington politics. Crafted more for its symbolism than for what little revenue it might raise, the tax strikes at a small, fragmented industry, leaving unscathed large marine manufacturers as well as companies with important political friends and powerful unions, such as Kansas airplane builders and Detroit automakers.

Already reeling from a deep 2-year-old recession in the marine industry, yacht makers say that the luxury tax has ground sales to a near standstill. At a recent trade show in New York, nary a yacht subject to the tax was sold. Several builders report order cancellations. As a direct result of the tax, yacht makers expect to lay off 8,000 workers and predict that one-third of the industry will shut its doors.

Some 450 boat builders make only yachts subject to the tax; most are small, labor-intensive firms. Yacht makers widely believe that because of job losses, the tax will cost the government money — in lower income and business tax receipts and higher outlays for unemployment insurance.



Hatteras Yachts says the tax harms workers who build $1 million boats such as this.

"The high-visibility politician wanted to get across to his constituents that he was going to tax the fat cats, and it's just not working," says Charles Pigadis, president of Lake's Yacht Sales Inc. of Freeport, N.Y., as he watches people file through the huge Hatteras cabin cruiser on display at the New York National Boat Show in Manhattan in mid-January.

Bryant Phillips, marketing director for Hatteras Yachts of High Point, N.C., explains: "Rich people don't build boats. The average workingman builds boats. Nobody in our company owns a Hatteras yacht. Unfortunately, it's the working person that is paying the price of this luxury tax."

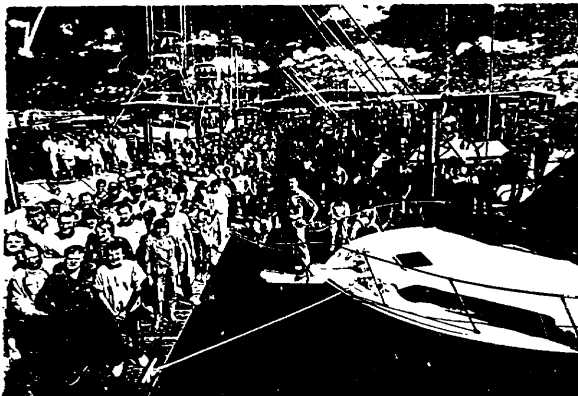
The tax was a key element of Congress's "soak the rich" tax drive, led by House Majority Leader Richard A. Gephardt of Missouri, who also frets about U.S. competitiveness. Yet yacht makers observe that luxury taxes are easily avoided by those intended to pay them. Yachts simply are not a necessity of life, even for the ultrarich. Faced with a steep tax, buyers stop buying.

The 10 percent luxury tax is levied on each dollar of a sale over $100,000. On a $1 million boat it hits $90,000; it reaches $690,000 on the $7 million top-of-the-line Hatteras yacht. The levy must be paid in addition to state sales tax, bringing the total excise tax to 18 percent in some states. At such levels of taxation, buyers simply defer purchases or turn to used yachts, which are exempt. For example, any buyer of the Trump Princess, which Donald Trump bought for about $30 million and which he intends to sell, will pay no luxury tax.

In any event, most buyers of large yachts, say builders, are small businessmen, not multimillionaires. Multimillionaires buy custom yachts costing $10 million and up, and they commonly register them in Grand Cayman or other Caribbean tax havens, escaping U.S. taxes altogether. The more typical yacht customer is a successful retiree who uses a boat as a second home. Many rely on bank financing.

These customers are in rebellion. "They are people who have, someplace along the line, done something right," says Rick Loh, sales manager for Grand Banks Yachts Ltd. of Greenwich, Conn., and they "are about taxed out. The attitude among most people is they'll be damned if they're going to pay a luxury tax." Adds an angry salesman at the New York boat show, "The guy who's retired and may have $250,000, he wants to fulfill his dream to own a cruiser. He's put up every dime he's got to buy a boat. It stinks. The whole thing stinks."

American yacht-making is an entrepreneurial affair, with production companies building maybe 50 to a few hundred yachts in a year, and custom makers a dozen or fewer. The National Marine Manufacturers Association says that 10,000 to 15,000 boats could be subject to the luxury tax. Builders are concentrated in Maine, Rhode Island, Florida, North Carolina and California. Both custom and production operations are labor-intensive, employing fiberglass laminators, carpenters, electricians, painters and upholsterers.



On the job at Viking's New Jersey plant: Healey says tax could finish off the industry.

"In our industry, the little guys build the big boats and the big guys build the little boats," says Robert T. Healey, co-owner of Viking Yacht Co. in New Gretna, N.J. Large marine manufacturers such as Outboard Marine Corp. of Waukegan, Ill., mass produce small boats and engines that cost well below $100,000.

The Washington budget negotiators decided on the luxury tax while sequestered from lobbyists and the press at Andrews Air Force Base last fall. They were also "sequestered from reality," charges David Drescher, senior vice president of Trojan Yacht Inc. of Lancaster, Pa. The reality in the boat industry is bleak, and the timing of the tax could not be worse, yacht builders contend. The boat builders' association says 150,000 people have already lost their jobs since boat production peaked in 1988; at that time some 650,000 were employed in the entire marine sector, which includes all boat builders, accessory suppliers and a large retail dealer network.

Viking just closed its plant in St. Petersburg, Fla., laying off half its work force — some 700 people — as a result of the recession. "Now where are we?" asks Healey. "We're in a recessionary economy that's going downhill fast. You put a 10 percent tax on that kind of scenario and you just finish off an industry. The only thing they've done is they've destroyed jobs."

"When this bomb was dropped on us," he adds, "we went out to Washington, and the response was, 'Well, guys, it's a done deal.' You couldn't talk to anybody."

The thresholds that the budget negotiators devised for items affected by the luxury tax are illuminating. Along with yachts, general aviation planes costing more than $250,000 are taxed, as are automobiles costing more than $30,000. The two other taxable items are jewelry and furs with a $10,000 threshold. Most private airplanes are priced under $250,000, so that the tax will hit primarily corporate jets. Even these jets, however, enjoy a wide loophole. If they are used for pleasure more than 20 percent of the time, they are exempt. Most small airplanes are manufactured in Kansas, home of Senate Minority Leader Robert Dole.

The United Auto Workers strongly supported the luxury tax on automobiles. As it happens, American made luxury cars, Lincolns and Cadillacs, for example, cost about $25,000 to $27,000 and so fall under the threshold. The luxury tax will hit the foreign makes such as Mercedes-Benz and BMW that compete with U.S. luxury cars.

The luxury tax may do heavy damage, however, to booming American yacht exports. "Export consumers have come to American boat companies for quality, reliability and the latest in design," says Trojan Yacht's Drescher. "America builds the best boats in the world." Yet by crippling domestic sales and revenues, the tax seriously weakens U.S. companies, leaving them with less investment capital. "It will diminish and dilute our effectiveness in exporting our product, no question about it," he says.

Congress chose the tax on yachts to make the simultaneous increase in blue-collar "sin taxes" on beer and cigarettes seem less unfair. Yet this is not the first time yachts have caught the eye of Capitol Hill. Don Dixon, former owner of the failed Vernon Savings and Loan Association in Dallas, docked High Spirits on the Potomac so that he could more conveniently entertain the congressmen he lobbied. According to The Washington Times, the yacht was "essentially an asset of the Democratic Congressional Campaign Committee," although prominent Republicans also numbered among the boating enthusiasts. Democratic Sen. Alan Cranston of California held a fund raising cruise aboard the $7 million Grand Cru supplied by David Paul, former owner of Miami's failed CenTrust Bank. Paul also contributed money to Dole and Gephardt, among many others. Taxpayers are now spending untold billions to bail out bankrupt S&Ls.

Washington has not yet produced any revenue estimates on the new luxury tax that take into account possible job losses. Viking's Healey, however, finds an analogy in New Jersey Gov. James J. Florio's attempt to collect a 7 percent excise tax on big trucks. For the first nine months of last year when the tax took effect, only 60 large trucks were sold in New Jersey, down from 700 sold the previous year. Buyers simply bought their trucks elsewhere. The tax was repealed, but not before a large number of truck dealers had gone bankrupt.

Healey expects plenty of "dead bodies" to pile up among yacht builders for the same reason. "Then all of a sudden people in Washington are going to say, 'My God, what did we do?' But that's after the fact."

Even if the luxury tax manages to raise more revenue than it loses, it will hardly dent the budget deficit. Federal tax revenues nearly doubled over the past decade, from $600 billion in 1981 to more than $1 trillion last year. The deficit exists because spending rose still faster. Despite the recent tax increase, the largest in U.S. history, the deficit is expected to hit $320 billion this year. "The need for more tax money is going to keep coming," worries Phil Fowler, vice president for sales and marketing for Hatteras Yachts. He says competitors have taken second place on his company's list of major business concerns. "As a manufacturer, at this point we're more scared about what the government may do."

— *Carolyn Lochhead*

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Mike Royko

As usual, Congress missed the boat

It seemed like a smart idea to congressmen at the time. In fact, it's always a clever political move, although not very original: Soak the rich. Let fat cats pay more tax because they can afford it.

And what better symbol of self-indulgent wealth than The Yacht? Yeah, look at those rich swells, in their fancy yachting whites, lounging in a harbor, guzzling gin and tonic while decent, hard-working folk can't afford a rowboat.

Nobody ever lost an election by boldly standing up to rich and pampered yachtsmen.

So Congress last year showed its concern for the middle class by enacting a special 10 percent tax on certain luxury items, including boats that cost more than $100,000.

They were in such a hurry to grandstand that they didn't bother to hold hearings, get opinions from the boating industry or talk to economists.

If they had, they might have been told what would happen. And they wouldn't be feeling as stupid as they are right now.

It didn't occur to them that somebody considering a $300,000 boat might say: "Let's see, in this state I have to add about $20,000 in sales tax. Now they want me to pay another $20,000 in federal taxes? So that's $40,000 more. And since I'm going to finance the deal, I'm also going to be paying interest on that $40,000. Hey, forget it. I'll buy a good used boat instead, or maybe I'll just charter one."

It seems that a lot of potential boat buyers thought that way. Which shouldn't have been a surprise. Not every big-boat buyer is a Rockefeller. Many are successful small businessmen, lawyers, doctors, and the boat is the big payoff of their professional lives. For some, it takes the place of the weekend house on a lake or in the country. Others use boats as retirement homes.

In a way, it was like slapping a 10 percent tax on any lake or beach house, weekend farm or other second home that costs more than $100,000.

But Dan Rostenkowski and those other creative minds wanted to show voters that they weren't afraid to soak the rich, even if the tax caused some fat cat financial pain.

And cause pain it has. But to the rich? Nah. Hardly any at all. The super-rich already have their yachts or can buy them in another country that isn't tax-goofy.

What Congress managed to do was put thousands of people out of work, close some small businesses and deprive the treasury of taxes that these thousands of working stiffs would have otherwise been paying.

Apparently Congress didn't know that boats are built by people. That's not surprising, since congressmen don't build anything. Mostly, they babble. Just watch C-Span.

But it's true. Boats are put together by craftsmen. The bigger and more luxurious the boats, the more skill and time are required.

When the tax took effect, right on top of a recession, people stopped buying, and the luxury boat business sank.

Boat companies had to lay off workers. The National Marine Manufacturers Association estimates that more than 19,000 jobs will be lost this year because of the tax.

Nobody knows how many of those 19,000 people will stay unemployed or find lesser jobs. But the association estimates that without incomes, they will be paying at least $30 million less in income tax. Maybe as much as $60 million.

Some boat companies, especially small, family-run operations, went out of business. For example, David Walters, 49, has been building quality yachts in Rhode Island for about 20 years. He sold about six boats a year, ranging in price from $300,000 to $600,000. He employed 40 people.

He had to close down. His 40 workers lost their jobs. Now he's in Florida, selling used boats, which aren't taxed, on commission.

"People are upset about this tax. They're not going to give 10 percent to the government, especially as a tax that doesn't apply to other recreations. Congress isolated on a very small group. It looked fashionable, going after people who have money. But it's the people who build boats that are being penalized.

"At the time I left New England, they had wiped out three of seven builders in my area. And the ones remaining are hanging on by their fingernails.

"Congress made a terrible mistake. This tax is revenue negative and put a lot of people out of work. I lost everything. I worked 60 and 70 hours a week, and everything I've built is gone. I could have stayed in business if they didn't have that tax."

And there is the ripple effect. The thousands of people who lose their jobs stop spending, and that hurts local merchants. The suppliers to the boat companies sell less, so they lay off workers, who pay less tax and spend less. And on and on it goes.

To show you how smart Congress is, this country's private boat industry is—or maybe was—the world's leader. It exported American boats. Well, maybe the Japanese will fill that gap.

And how much revenue has the boat tax brought to the federal government? Economists aren't sure, but they say it's possible that the cost of collecting it is wiping out what is being collected.

That means Congress came up with a tax that loses money, has wiped out thousands of jobs and deprives the treasury of millions in income tax dollars. Not to mention the misery that comes with being tossed out of work or losing a business.

This is just another of many reasons congressmen should always sit up straight in their chairs. If they tilt their heads to the side, their brains might fall out of their ears.

CAMDEN, NJ
COURIER-POST
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PHILADELPHIA METROPOLITAN AREA

Boatbuilders struggle to stay afloat

By BERNIE WEISENFELD
Courier-Post Staff

South Jersey's yacht-builders are in troubled waters.

A federal tax has hit hard at the industry, already struggling in a becalmed economy.

The tax is equal to 10 percent of the price of new recreational boats costing $100,000 or more. It's meant to help reduce the nation's budget deficit, but local boatbuilders say the levy could sink their industry.

Since the tax took effect Jan. 1, they say, new boat sales have plummeted and business conditions have gone from bad to worse:

● Egg Harbor Yacht Co., which once employed 250 workers in Egg Harbor City, filed for bankruptcy protection earlier this year. The Atlantic County firm, now down to a half dozen employees, plans to close in about a month.

● Viking Yacht Co. has cut its payroll to about 250 people from almost 700 workers a year ago. The company's sales of 30- to 60-foot fiberglass motorboats are off by 60 percent from a year ago, a spokesman says.

Viking, based in New Gretna in Bass River Township, Burlington County, laid off 50 workers last month. Earlier this year, the firm closed a 550-worker factory in St. Petersburg, Fla.

● Employment's falling, too, at Jersey Boat Co. of Lumberton. "We're down from 72 people (last fall) to 30 and counting," said production supervisor Joseph Palecki.

● A ripple effect is hurting suppliers such as Johnson & Towers, a Mount Laurel firm that builds marine engines.

"For every boat they don't sell, we don't sell two engines," said Al Harris, a spokesman for the firm. "All those big boats take two (engines) at a time, so we are down two-to-one."

Johnson & Towers' marine-motor unit now employs six people, down from 20 at year-end 1990, Harris says.

At Egg Harbor Yacht, general manager Robert Hazard calls the tax "the final nail in the coffin" for South Jersey's once-thriving yacht industry.

"From what I understand from talking with major boatbuilders, since Jan. 1 there has not been one boat sold domestically," he said.

Courier-Post photo Tina Markoe

Slump: Robert Hazard, general manager of Egg Harbor Yacht Co., says the federal luxury tax is to blame for his firm's problems. The firm will close in about a month.

Cape May yacht dealer Dick Weber recently wrote his congressman, Rep. Bill Hughes, D-N.J., that he had no new-boat sales in January and February — down from revenues of $4.2 million a year earlier.

"The industry is virtually at a standstill," Weber wrote.

Nationwide, the boat-building industry has lost about 8,000 jobs since Jan. 1, says the Chicago-based National Marine Manufacturers Association.

Some boatbuilders are changing course in a bid to survive.

Viking Yacht recently decided to absorb the tax payment in an effort to spur sales, said company chairman Robert Healy. It's too early to see results from the offer, he said.

The company also is relying on sales to foreign buyers, who are exempt from the tax.

Meanwhile, the boatbuilding industry is lobbying hard to have the new tax repealed.

Industry members say the tax has failed to produce revenue because boat buyers either have deferred purchases or have bought used boats, which are not taxed.

Also, critics say, the federal government has lost income taxes from laid-off boatbuilders, while state revenues from boat sales and registrations have fallen.

ATLANTIC CITY, NJ
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Critics of boat tax say levy will cost more than it saves

By ELAINE ROSE
Staff Writer

The new federal tax on expensive boats will cost the government more to collect than it will produce in revenues, the chairman of a national coalition for its repeal said Monday

The National Coalition to Save Jobs in Boating is gathering support in 27 coastal and Great Lakes states to pressure Congress into rescinding the luxury tax said chairman Robert T Healey chairman of the board of Viking Yachts in Bass River Township

The 10 percent excise tax on items costing more than $100,000 was enacted in late October, when Democratic Congressional leaders hoped to reduce the federal deficit by taxing the rich, Healey said

Politically, it was great for the November elections," he said "But after the election they found it was a big blooper"

Boating sales are off 60 percent to 70 percent throughout the country, and the luxury tax is the "coup de grace" that could bring an already troubled industry almost to a standstill, Healey said

The federal government has estimated the tax will raise $3 million for its coffers this year, but "by Washington standards, that does not even get near their collection costs," Healey said

Add in the cost of unemployment benefits for laid-off workers and the income taxes they don't pay, and the government will lose money with the excise tax said Kathy MacCausland, who is in charge of promotions at Viking

The National Marine Manufacturers Association has estimated about 8,000 people in the boating industry could lose their jobs as a result of the luxury tax.

Rep William Hughes, D-2nd, said Monday he is a co-sponsor of House Bill 951, a repeal measure filed several weeks ago in the House Ways and Means Committee

But Hughes said the tax was initiated by Republicans who wanted to increase revenues while keeping President George Bush's campaign promise not to raise taxes — and effects on the economy were not studied in advance

"It received very little analysis, no studies were commissioned, and there was no effort to determine the effect on the boating industry, which was already in a depression," Hughes said

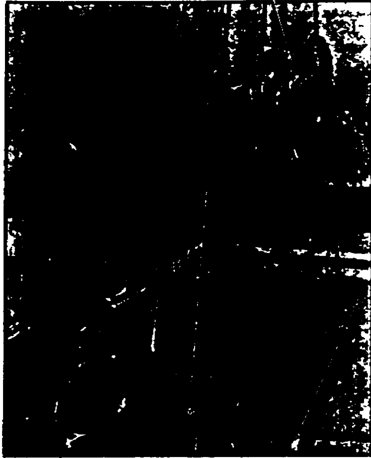
Hughes said he has seen estimates that it could cost up to $100 million to collect the $3 million the new luxury tax is expected to generate this year.

While optimistic about eventual repeal of the tax, Hughes said it will be a fight because representatives of states with no boating industry still support the measure.

The southern New Jersey boating industry, has a 40 percent unemployment rate, and the tax could mean lower sales and even more layoffs, Hughes said.

South Jersey Yacht Sales laid off 20 of the 35 workers in its service department, the first furloughs in the dealership's 10-year history, Weber said

"The luxury tax is still a major thorn in our side," said George Walter, vice president of communications at Viking Yacht.



Press photo by Neal Roberts

Molds are unloaded Monday at Viking Yachts

There were some signs of good news Monday at the Viking Yacht docks where cranes were unloading about 300 tons of equipment that arrived from Florida over the weekend.

Last November, Viking Yacht officials announced plans to close the Florida facility, which employed several hundred people, and consolidate operations at the New Jersey plant

The molds from the Florida plant will be used to make 57- to 72-foot motor yachts, or "literally almost a home afloat," Healey said. Sport fishing boats up to 58 feet long will continue to be manufactured in New Gretna, he said.

Construction should begin in about a week on two motor yachts destined for European ports, Healey said.

And that may mean good news for some of the 208 workers who were laid off in September, when company officials said the Persian Gulf conflict and the savings-and-loan crisis led to a decline in boat sales.

Viking hopes to bring back 50 to 100 workers within a month, depending on orders for new motor yachts, Healey said.

ASSOCIATED PRESS
NYC METRO WIRE

^By HENRY STERN=
^Associated Press Writer=

New Jersey's boat industry faces an uncertain future as the recession and new luxury taxes combine to discourage prospective buyers. And the situation is made worse by boat owners, who are driving down prices by unloading their vessels.

Boat builders and boat sellers said Tuesday that the new year will likely continue a plunge that quickened last year with the recessionary economy.

That could mean mo re layoffs in an industry that has already lost hundreds of jobs. The latest figures available showed there were 1,100 people employed in the industry in 1989 in Atlantic, Cape May and Cumberland counties, where the industry in New Jersey is centered. There were no statewide figures available.

''I've never seen anything like it,'' said Hans Mikitis, the owner of Master Shipwrights in Keyport. ''It's just devastating. This past year has been the pits ... I'm picking through stuff right now looking for business.''

Mikitis, who has custom built boats for 34 years, said he has received a fraction of the inquiries this year that he did in the past. A few years ago, he employed 22 people; last year he had four; this year it's just him.

''I don't know how long I can wait for this to come around,'' he said.

Mikitis attributed his company's freefall to the poor economy, but dismissed the impact of higher gasoline prices. Larger manufacturers share Mikitis' evaluation of the past year and they sense gloom for the year ahead.

A federal luxury tax that began Jan. 1 was blamed by many for the bleak outlook. The 10 percent surcharge is applied to the portion of the price that exceeds $100,000. For example, the tax on a $500,000 boat would be levied on $400,000, for a total of $40,000.

The National Marine Manufacturers Association estimates the surcharge will cost 8,000 jobs over the next two years.

''I think it's going to be a very slow year for everybody,'' said Maria Henriques, the office manager of the 20-employee Henriques Boat Works in Berkeley Township. ''There might be layoffs. We just don't know at this point. We just have to hang in there.''

Henriques, whose company makes boats in the $146,000-$350,000 price range, said cash-strapped boat owners trying to sell their vessels have hammered down prices.

The savings and loan crisis also has contributed, drying up funds for anybody who might want to take out a loan to buy, Henriques said.

Ken Jensen, a vice president at Post Marine in Mays Landing, anticipated a 30 percent drop in business this year and said federal lawmakers should have been more sensitive to the industry's plight.

''People might have shrugged this tax off during a strong healthy economy.'' Jensen said.

The dozen or so boats made this year by Post Marine cost between $400,000 and $600,000. Jensen said he's laid people off, but he wouldn't say how many.

Last year, instead of the usual wait lists for boat slips at marinas around the state, 14,000 of the slots for boats went unused, officials said.

With the boat show season set to begin, including one this week in New York City, boating officials say the next couple of months will tell.

''Maybe then things will start to move,'' Mikitis said. ''I don't know.''

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JERSEY CITY METROPOLITAN AREA

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Associated Press

Hans Mikitis, a boat builder in Keyport, shows off 26-foot steam launch worth $100,000 that he completed recently. He says business has never been slower in his 34 years as custom shipwright.

Boat business sinking in high taxes, low customer demand

By The Associated Press

New Jersey's boat-building industry faces an uncertain future as the recession and new luxury taxes combine to discourage prospective buyers. And the situation is made worse by boat owners, who are driving down prices by unloading their vessels.

Boat builders and boat sellers said yesterday that the new year will likely continue a plunge that quickened last year with the recessionary economy.

That could mean more layoffs in an industry that has already lost hundreds of jobs. The latest figures available showed there were 1,100 people employed in the industry in 1989 in Atlantic, Cape May and Cumberland counties, where the industry in New Jersey is centered. There were no statewide figures available.

"I've never seen anything like it," said Hans Mikitis, the owner of Master Shipwrights in Keyport. "It's just devastating. This past year has been the pits ... I'm picking through stuff right now looking for [illegible]

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"I don't know how long I can wait for this to come around," he said.

Mikitis attributed his company's difficulty to the poor economy, but dismissed the impact of higher gasoline prices. Larger manufacturers share Mikitis' evaluation of the past year and they sense gloom for the year ahead.

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The savings and loan crisis also has contributed, drying up funds for anybody who might want to take out a loan to buy, Henriques said.

Ken Jensen, a vice president at Post Marine in Mays Landing, anticipated a 30 percent drop in business this year and said federal lawmakers should have been more sensitive to the industry's plight and not imposed a heavy tax in a weak economy.

TIMES
TRENTON, NJ
SUNDAY 86,979

FEB 24 1991

Major move is on to save recreational boating jobs

MIAMI BEACH, Fla. — Tired, dog-tired.

That's what one gets when he conscientiously covers the Miami International Boat and Sailboat Show. Completely covering the show makes a believer of anyone who had doubts that this show is actually the world's largest boat show.

Covering this show means that you not only cover the core of the show in the Miami Beach Convention Center and the acres of show-grounds surrouuding it, it also means that you take the shuttle bus to the show's sailboat component at the International Yacht Harbor and to the Biscayne Bay Marriott Marina where powerboats of large dimensions are exhibited in the water.

However, to members of the boating press who have already reviewed most of the boats on display, there's yet another facet of the show, one that's not open to the general public, namely, press conferences. And, of course, there's the opportunity to interview industry leaders about subjects that will eventually effect your readers.

A SUBJECT The Times wished to explore is one that is important to many residents of the Garden State — the birth of the Save the Jobs Coalition.

Thousands of jobs are at stake in the recreational boating field in New Jersey. If everyone whose living depended on the health of New Jersey's recreational boating industry resided in one municipality, it would match Hamilton Township's population.

To make a point, 32 of the exhibitors at the Miami Beach show were New Jersey businesses. From the Times local circulation area there was the Switlik Parachute Company's booth which was manned by Richard Switlik, and which featured life rafts. The company no longer manufactures parachutes.

To get the story on the Save the

BILL GARRY
Boating

Jobs Coalition, it was necessary to interview two people who were leading the group organizing the effort, Robert Healey, a former Trenton resident, who is CEO of the Viking Yacht Company in New Gretna, N.J., and Jeff Napier, president of the National Marine Manufacturers Association (NMMA).

FINALLY CATCHING up with Healey between the many meetings he was attending relating to this organization, the goal of which is to bring about the repeal of the 10 percent luxury tax congress imposed on that part of the cost of new boats that exceeds $100,000, we got our story.

According to Healey the coalition has organized groups in 27 states where boating is predominant in some fashion — manufacturing, recreation, etc. Chairmen have been appointed in these states to organize boating public support for the repeal of the luxury tax legislation. Also, to get their congressmen and senators to join the Congressional Boating Caucus and to be co-sponsors of the repeal legislation. Also, to have them vigorously support repeal of the luxury tax legislation.

According to Healey, area Congressman James Saxton is an ardent supporter of the repeal effort. Healey also stated that Senator Bill Bradley recently met with a group of New Jersey yacht builders in Marlboro, N.J. These yacht builders who have already laid off hundreds of employees include Viking, Ocean Yachts, Jersey Yachts, Silverton-Mainship, Pacemaker, Egg Harbor, Henriques and Post Marine.

IN MY interview with NMMA's Jeff Napier, he stated, "If we can get 30 to 40 percent of the congress to sign on the bills, we'll establish enough momentum to go to hearings with the committee having jurisdiction and probably get the bill recommended out of committee."

Napier went on to state that the Joint Committee on Taxation in congress has just about admitted that the excise tax on boats will be a revenue loser. In a letter to Senator John Chafee the committee estimated that the boat luxury tax would bring in about three million dollars in 1991. Tax specialists indicate the cost of collection and enforcement will exceed the revenues that are raised.

Boating industry officials estimate that 6-8,000 American boat building jobs will be lost as a direct result of the new tax. Napier stated that to sacrifice American jobs and to jeoparadize our boating export plus position is unconscionable.

Getting back to Healey, he pulled no punches with the statement that, "The No. 1 enemy is not the marketplace but is our government. The American yacht builder knows no equal around the world in production manufacturing."

Healey continued, "In other countries you have a number of smaller boat builders, but in the manufacture of quality yachts the American builder has no equal." Healey continued, "We have Mitsubishi as our dealer in Japan. They build boats but they buy our boats and sell them over there. We also have dealers in seven major countries in Europe."

■■■

Remember, today is your last opportunity to attend the Jersey Coast Boat Show at Monmouth Park. Hours are 11 a.m.-7 p.m.

Bill Garry is Times boating columnist.

TRENTONIAN

TRENTON, NJ
DAILY 68,565

TUESDAY
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Boating industry seeks tax repeal

As the boating market cooled in 1989 and 1990, production fell by 40 percent and jobs were lost. Compounding the problem is the recent enactment by the government of an excise tax on large craft, user fees on boats 16 feet and longer, and a boating gasoline tax hike.

An estimated 19,009 people are employed in all phases of the boating industry in New Jersey; 13,244 in Pennsylvania.

"A 10 percent tax increase on our products causes a 20 percent decrease in sales," explained National Marine Manufacturers president Jeff Napier. "The bottom line means even more industry jobs will be lost."

Napier said the boating industry is joing forces with boating consumers to work for repeal of the new taxes.

CAPE MAY, NJ
STAR & WAVE
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ATLANTIC CITY METRO AREA

Boating slump costing economy

New tax partly to blame

By JIM O'DONNELL
Star and Wave Correspondent

When a boat dealer goes from $4 million in sales to zero, that industry is in deep trouble.

Dick Weber, president of South Jersey Yacht Sales of Cape May, says forcefully that his company went from $4 million in sales in the first two months of 1990, to zero sales during the same period this year.

He attributes the sales wipeout to a variety of factors, including the current economic turndown. He reserves his harshest criticism, however, for the "worst of all combinations": a seven percent state sales tax, a 10 percent federal tax, on new boats costing $100,000 or more; a new boat user's fee of $25 to $100, and a falling economy.

Boat manufacturers, dealers, equipment suppliers, marinas and repair yard people agree that the industry has been in a slump for four years. As Bill Kocis, owner of Cape May Marine says, "we were the first to feel the effects of the recession".

About the new "luxury" tax and fees, they share the sentiments of Pete Cirnniciome of Tony's Marine Supply and Railway of Cape May: "They kicked an industry that was already down."

Cirnniciome says the tax and user's fees won't raise the revenue forecast. Less people will buy and use boats, he explains. Kocis adds that it will cost more to administer than the tax money it will raise. The feds were hoping to raise $127 million, but industry sources say they'll lose more than they collect. Laid-off workers won't be paying income tax, and they'll be collecting unemployment money.

"The spinoff from these taxes hurt a lot of people," Cirnniciome said.

(Please Turn to Page 5)

STIRRING THE WATERS — Dick Weber, president of South Jersey Yacht Sales of Cape May, is rallying boaters to repeal taxes they consider unfair to industry. Economic slump and new taxes, Weber says, devastating this year's boat sales and badly hurt other marine businesses.

photo by [illegible]

Boats

(Continued from Page 1)

Weber concurs: "We have been in business here since 1980. We never laid anyone off. Before the winter is over, we might have to layoff 60 to 70 percent of our work staff."

In a letter to Congressman William J. Hughes (D-2nd), Weber emphasizes that "the industry is virtually at a standstill, with thousands laid off, small business owners folding and major manufacturers literally struggling for survival."

He adds: "We desperately need your help and instead, there is a non-ending barrage of new government disincentives."

Hughes, who has consistently opposed boater fees and taxes, is supporting two bills in the U.S. House that would repeal both levies. They are H.R. 534 (user's fee) and H.R. 951 (excise tax). Boaters are optimistic that Hughes' clout, along with that of other New Jersey congressmen, and those from heavy boating states, will be sufficient for repeal.

It is estimated that there are 600,000 workers in the industry. Boaters feel these workers were served as sacrificial lambs to appease those who were intent on "soaking the rich" during federal budget negotiations. Layoff and closing estimates run from 100,000 to 150,000 nationwide. Six South Jersey boat manufacturers and an engine company have laid off approximately 2,100 people, according to the National Marine Manufacturer's Association.

One old-line company, Egg Harbor Yacht, has already filed for bankruptcy under Chapter 11. By November of last year, it had laid off 90 percent of its 230-person workforce. Producing yachts in the $150,000 to $1 million range, it had cut its production to two boats a month, down from 120 a year. It still wasn't enough. On Jan. 10 it filed for protection from its creditors, listing assets of $8.3 million and liabilities of $6.6 million.

Ernie Utsch of Cape May's Utsch's Boat Sales points out that people who have the ability to earn $100,000 to buy a boat, also have the ability to say "no" to purchasing. They can also purchase it through a corporation, most likely not set up in New Jersey, to avoid the tax. Persons in higher income brackets often have multiple residences. They can buy and register boats in the state that has the best tax climate, he said.

William J. Healey, president of Viking Yachts of New Gretna, says everyone's feeling the crunch: "Most of our market is now overseas."

Healey said because of the almost complete disappearance of the U.S. market, Viking had to close a Petersburg, Fla. plant that employed 700 people.

Viking sold 24 boats in the last two months of last year, before the federal excise tax went into effect Jan. 1, 1991. Normally, they sell six or eight in November-December, according to Healey. Viking sells yachts in the $150,000 and up range. A person buying one of their lower-priced models, last year, saved $35,000.

Healey points out that its not the purchaser that gets hurt by the tax, but the blue-collar employee carpenters, metal workers and maintenance people, who depend on boat manufacturing for their livelihood. He adds that when production is curtailed, suppliers also have to cut their workforces.

Healey said a grass-roots campaign is being mounted to repeal the tax and user's fee. The "Coalition to Save Jobs in Boating" is being chaired by Healey's brother, Bob. With the help of the national Marine Manufacturers Association, they are establishing political action committees in 27 boating states. Chairmen and co-chairmen are being selected from industry leaders. They are also mounting a public relations campaign to show that the taxes hurt the working man, not the well-to-do.

The manufacturers have willing allies in this campaign, the 17,000 dealers nationwide. As indicated, local dealers are already turning up the heat on elected officials. They want action now, Weber said.

JoAnne Krahe, spokesperson for the New Jersey Marine Trades Association, has been circulating petitions among the estimated 200,000 New Jersey boat owners to repeal the user's fee. They have collected 5,000 signatures.

"We are just beginning to collect signatures for HR 951 (the excise tax)," Krahe explained.

She said the MTA would be seeking support for repeal of the levies at the Cape-Atlantic Boat Show, April 19-21, at the Harbor Cove Marina Basin, Somers Point.

TRENTON, NJ
TRENTONIAN
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TRENTON METROPOLITAN AREA

Pols should know elasticity theory — Jersey's didn't

The United States is in the middle of an elasticity crisis.

This does not mean that nationally our socks are sliding down our ankles. Instead, it describes an economic situation so simple that almost no one understands it.

Elasticity, or "price elasticity of demand" as it is taught in first-year economics courses, means this: Some goods and services continue to sell just as well, even when the price goes up.

Sylvia Porter

And the sales of some goods and services drop quickly when the price goes up only a little.

That's a very powerful idea, when carefully used. You should understand it because it can help you determine when policymakers know what they're talking about. (It's also useful when setting the prices for goods and services that you may offer.)

A joke that used to be told among college professors observes there must be an "economics gland" somewhere in the human body, and those who seek public office almost always have it removed.

The country's experience with elasticity in recent months suggests that the joke may be true. (It could be that the confusion comes in the term "elasticity" itself, because it seems to work just as well backwards: those items most sensitive to price changes are said to be elastic, while those that continue to sell no matter what the price are described as inelastic.)

A famous recent political-economic scandal took place in New Jersey and involved the price elasticity of demand as applied to heavy trucks. The state government, facing a heavy deficit and noting that New Jersey had a thriving heavy truck sales industry, placed a substantial tax on such sales. It would bring in many millions of dollars, the lawmakers reasoned.

They did not take into consideration the extreme elasticity — price sensitivity — of the demand for trucks. The new tax raised virtually no money. Instead, the state's truck dealers stopped selling trucks. A strong industry became a weak one, the state made no money, and citizens grew angry. (The tax was repealed, but only after truck dealers had lost a year's sales, plus whatever residual sales will be lost as customers established relations with dealers in other states.)

A similar situation may be developing nationally through the new federal tax law. One of its provisions is a surtax on so-called luxury items — expensive cars, boats, airplanes and the like. It is no doubt very politically popular to tax "luxuries," for they are the province of an ill-defined group called "the rich." Beyond that, though, the idea doesn't make much sense.

Consider, for instance, the 10 percent additional tax on boats costing more than $100,000. The boating industry has already fallen on hard times. Last summer in some regions there were as many as 25 percent fewer boats in the water. This doesn't mean only that sales were down but that those who already owned boats were not launching them for the season. The point had been reached where costs were too high. The prices of used boats were falling.

Adding 10 percent will work, then, if the goal is to discourage people from buying boats. As a revenue raiser, though, it is probably doomed to failure. Indeed, the law was written, in part, to discourage sales.

> New Jersey's strong truck-sales industry became weak, the state made no money, and citizens grew angry.

The National Marine Manufacturers Association (NMMA) estimates that the resulting loss of business will cost the industry 8,000 jobs, not counting the reduction in maintenance and marina business. This means that 8,000 taxpayers will, for the short term at least, become former taxpayers. The NMMA says this revenue loss will more than offset any increase in revenue brought about by the new tax.

All because boats are elastic. The demand for them is sensitive to price change.

What sort of things, then, are inelastic? What products continue to sell even when the price goes up?

The two leaders in this field, the economists and market analysts tell us, are cigarettes and liquor. Relatively great increases in price have had small effects on sales.

If the purpose is to raise revenues, that's where you impose the taxes.

RECORD
HACKENSACK, NJ
DAILY 161,969
THURSDAY
FEB 28 1991
64 BURRELLE'S

Sales picture growing more bleak

The numbers are in, and they confirm what signs have indicated in recent months: These are bad times in the recreational boating industry, and the outlook is that they will get worse.

Figures released by the National Marine Manufacturers Association last week show that boat sales dropped in 1990 even more than the year before.

NMMA estimates that 504,100 boats were sold in the United States and its territories last year, down almost 21 percent from the 637,500 sold in 1989, which was a drop of 14.9 percent from 1988, when sales reached a record 749,020.

The figures include all categories of vessels, from sailboards to cruising yachts, and each segment shows a decline.

Outboards were the most popular, with 227,000 units sold — more than half of all boats sold. But that was a drop of 22 percent from last year and marked the first time since 1983 that outboard sales fell below 250,000.

Inboard cruising yachts valued at more than $100,000 were among

KEVIN DeMARRAIS

BOATING

the hardest-hit, with only 7,500 sold last year, down from 12,300 in 1989 and 13,500 in 1988.

"We used to think the big-boat market was economy-proof or recession-proof," NMMA spokesman Greg Proteau said. "This year proves that is no longer true. We think that's going to be worse before it's going to get better because of the new tax Congress put on us."

Proteau was referring to the 10 percent luxury tax on boats costing more than $100,000 that took effect Jan. 1.

The boating industry has gone through similarly bleak periods in the last two decades and has rebounded each time. Sales rose steadily from 436,500 in 1970 to 729,000 four years later before falling to 529,050 in 1975, and went through other ups and downs before peaking in 1988.

And while sales dropped, recreational boat use and ownership continued to climb, according to NMMA estimates.

Last year, 73.37 million people went boating, up from 72.67 in 1988. And boat use increased from 15.07 million in 1988 to 16.02 last year.

Because sales have declined for three years, the industry feels there are boat owners who are ready to trade, but are hesitant because of the recession, Proteau said.

"It was established in the '70s and '80s, in people who are hard-core boaters, they're going to want to change what they're using," Proteau said. "Every three to five years, they're going to turn those things. They haven't been doing that with any regularity the last two years. So we feel we have a latent demand built up.

"If we get people feeling comfortable about making major purchases, and they get back in line again, we'll see this group coming back into the market with very strong intentions, and we'll see the new boat buyer, because they're now totally out of it."

Attracting new boaters is a key to the industry's long-term success. That is one segment of the population that has been conspicuously absent from boat shows over the last two years.

• • •

U.S. Coast Guard Auxiliary Flotilla 10-9 begins classes in small-craft handling and sailing starting at 7:30 Monday night at Emerson High School. The classes are part of Emerson's community education program, and a $35 registration fee is required. All ages are welcome.

To register, contact James Bayley at The Billano School, Linwood Ave., Emerson, N.J. 07630; or call 262-5502.

This article contains material from The Record's news services.

MILLVILLE, NJ
MILLVILLE NEWS
—D 5,000—
VINELAND-MILLVILLE MET AREA

Boatin' With Beecroft

By RICHARD BEECROFT

The toll of the new federal boat tax, a whopping 10 percent of all over $100,000 that a boat costs, is already being felt locally.

Silverton Marine Corp. of Millville, plans to halt operations for a month and has sent layoff notices to 118 employees at the plant on the banks of the Maurice River. The employees were told to check in about the middle of February to see if the situation had changed. The company plans to reopen as soon as conditions improve sufficiently.

It may be hard for some of us to feel sorry for the chaps who buy boats worth more than $100,000. But, with the modern credit system, there are more of them you think and not all are the "fat cats " that Congress believes.

The new taxes will start being collected some time later in the Spring. The Coast Guard, which will be the colllection agency (but gets none of the benfits) hasn't made up its mind on the system to be used yet.

But, don't gloat. Every boat owner will feel the squeeze. There are new taxes for smaller boats, too. The small boat owners will pay from $25 to $100 depending on size.

The boat manufacturing industry has been in a slump for some time and the new taxes that took effect on Jan. 1 is making the decline steeper. The ironic part of the whole thing is that it is probable the loss in revenue as a result of the slump in the boat manufacturing industry will be greater than the new taxes collected. The downward trend will carry over, too, into many associated trades.

Richard Schwartz,. president of the B.O.A.T./U.S., the nation's largest boating organization, urges us to write to our Congressmen and Senators to have Congress repeal the tax which is known as a "boat use tax." The dropped "user fee" because it implied you would get something for your money. It admittedly does nothing for either boatmen or the Coast Guard but goes into the general fund.

The law itself flagrantly states "The collection of these charges does not constitute an expressed or implied promise by the United States government to perform any service activity in any certain manner or at a certain place." In plain words, pay up sucker just for the right to put a boat in the water,

Meanwhile, the National Marine Manufacturers' Association (NMMA) has just released it annual statistics for last year, 1990. It shows a great drop in the sales of every type of boat, from yachts to tiny canoes, outboard motors and accessories throughout the country.

There are some people employed in the boat manufacturing industry in every state in the nation including the District of Columbia. They total more than 250,000 persons, all told, and hundreds of thousands more are employed in associated businesses and industries.

The figures show, too, that about 80 percent of all boat owners are working people in the under $50,000 a year income catagory. Many of the owners are also workers in the industry, many of whom may lose their jobs. We have already experienced that in Millville.

For those who may be considering buying a new boat stripped down to keep it below the $100,000 critical price tag, forget it. The new law says that all accessories, equipment and gear that would be included in a complete boat, will be added to the price if it is bought within six months of the original purchase. Maybe you can buy a bare hull and then wait six months before completing it, but I'd check it with my tax consultant first.

The new law isn't all smoothed out yet, but any way you look at it it will cost you more to own a boat, any boat, this year than last. It is probable that the Coast Guard will issue stickers for your boat to indicate that the tax has been paid.

All this confusion hasn't helped the boat show business either, where patronage as well as sales have fallen.

But cheer up. It's only 54 more days to Spring.

JAN 27 1991

Boats increase, boating industry employment declines in state

By BILL GARRY
For The Press

If everyone employed in the recreational boating industry in New Jersey lived in one municipality, that municipality would have approximately the same population as Atlantic City.

About 25 years ago a similar survey revealed that if those employed in the recreational boating industry in New Jersey lived in one community, it would be the third largest city in New Jersey.

Included in the above compilations are those from manufacturing, retailing and service. Over the 25-year period, the number of boats plying the waters of this country jumped from just under 10 million in 1975 to more than 16 million in 1990.

Why, in the face of such growth in the number of boats, has the number employed in the industry decreased? Blame our state government, lower labor costs in the south and increased real estate values.

On the eve of the opening of the Philadelphia Boat Show, Jeff Napier, president of the National Marine Manufacturers Association (NMMA) addressed the effect the new luxury tax and the so-called user tax would have on the economy of the boating world.

Napier states: "What's disturbing is that any revenue gains will be offset by lost payroll taxes from the workers thrown out of jobs."

A few months ago at a hearing of the Congressional Boating Caucus in Washington, Napier painted a discouraging picture about the probable effect of the proposed luxury tax and user fees on recreational boating and the boating industry.

Napier said that an estimated 600,000 people were enjoying employment in the boating industry in 1988. Today, the figure is estimated at less than 500,000. NMMA has pointed out that boating is a cyclical industry and the market cooled during the two-year interval, and production fell just over 40 percent.

According to Napier. "Studies show a 10 percent tax increase on boats and boating products causes a 20 percent decrease in sales."

Earlier this week, a New York Times article headlined "New tax could prove to be luxury the IRS can't afford" reinforced Napier's argument about the luxury tax.

The article contained this observation: The luxury tax Congress adopted in its closed-door budget sessions last year may cost retailers and the Internal Revenue Service more to collect than the revenue it brings in, according to some tax experts and business leaders.

The NMMA points out that the boating industry can mean a start for high school students at marinas, for entrepreneurs at marine dealerships and white collar jobs for salespeople, executives and engineers. Also, business allied to the industry employ people in publishing, finance, insurance, chemicals, metals, electronics, etc.

There is a need for action. Write to your congressman and senators asking for the repeal of the luxry tax and the user fee.

(Bill Garry is a member of the Boating Regulation Commission and president of the Boating Writers International. His column appears in The Press on Sunday.)

356

PRESS
ATLANTIC CITY, NJ
DAILY 79,999
MONDAY
NOV 5 1990

Luxury boat tax seen as threat by boatbuilders

By DONALD WITTKOWSKI
Staff Writer

A new luxury tax on expensive boats, a result of a soak the rich sentiment embraced by Congress this election year, threatens boat manufacturers already sinking in a sea of red ink, industry officials say

The 10 percent surcharge on new boats costing more than $100 000 is among the tax provisions in the federal budget approved last month by a bitterly divided Congress and now awaiting President Bush's promised signature

The levy will be imposed on that portion of the price above $100,000 meaning the buyer of a $200 000 boat, for example will face a luxury tax of $10 000

Although middle-class America might not care that those wealthy enough to afford expensive pleasure craft will be hit harder, boatbuilders and retailers are predicting the tax

See Boats, Page A4

Press photo by Ben Fogletto

John Rotelle Jr., owner of Cape Island Yacht, predicts some retailers will fail this winter

Boats:

Luxury tax bad news for boatbuilders

(Continued from Page A1)

will devastate the industry

However, there may be a buying spurt from now until the tax takes effect on Jan. 1 as boaters rush to save money, officials said. Later on, production and sales are expected to plummet.

"The first quarter of next year will be dead," said John E. Leek III, president of Ocean Yachts Inc. in Mullica Township, which manufactures boats ranging in price from $100,000 to $1 million

"As bad as the boat business has been — we're down now 40 to 50 percent — we may go down another 40 to 50 percent," said John Rotelle Jr., owner of Cape Island Yacht Sales & Marina in Somers Point, whose boats sell for $100,000 and up

"It will be very difficult. I think a lot of retailers won't make it through the winter," Rotelle said

The boating industry already is in the midst of hard times due to the recession in the Northeast, the savings and loan crisis that has tightened credit, and overproduction by manufacturers.

"The marine retail industry probably is in its worst slump in the last two decades," said Phil Keeter, executive director of the Marine Retailers Association, a national lobby representing 4,000 boating retailers.

Soaring fuel prices brought about by tensions in the oil-rich Persian Gulf region following Iraq's invasion of Kuwait in August have further depressed the market.

Boatbuilders have been laying off workers and cutting back on production to avoid going under. The luxury tax will result in the loss of 8,000 more jobs in the next two years, according to the National Marine Manufacturers Association, the boatbuilders' national lobby

"There has been a lot of nervousness brought on by the luxury tax," said Robert A. Hazard, national marketing manager for Egg Harbor Yacht Co in Egg Harbor City. "It's not helping us at all."

Egg Harbor Yacht has slashed its work force by 90 percent and cut production to two boats a month, down from a peak of 120 boats a year. Its boats range in price from $150,000 to $1 million

Egg Harbor City Mayor James E. McGeary, noting the firm's plight and the difficulties of other boatbuilders in southern New Jersey, wrote to Bush last month urging him to reject the luxury tax

U.S. Rep William J Hughes D-2nd, voted against the budget in part, because of the expected harm the tax will have on boat manufacturers.

Hughes, whose district includes much of the New Jersey shore, also objected because the budget includes what he said are unwarranted new user fees on boaters plying waters patrolled by the U.S. Coast Guard

Marine officials also noted that the budget imposes a 5-cents a gallon increase in the federal gasoline tax, another expense expected to hurt the boating industry

Although the boatbuilders have complained of being singled out by Congress, the budget also calls for a 10 percent luxury tax on expensive planes, cars, jewelry and furs to raise revenue to help offset the federal deficit.

"We were basically held up as a sacrificial lamb," Leek said of the boat manufacturers

Hughes tried unsuccessfully to convince the House Ways and Means Committee and the House Democratic Caucus to push through a compromise to have the luxury tax also apply to the sale of used boats

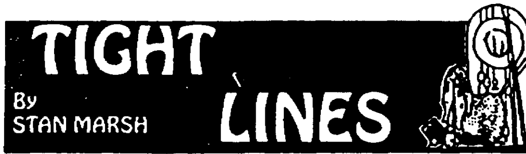
Under Hughes' plan, which was supported by the boating lobby, there would have been a 5 percent surcharge for both new and used boats costing more than $100,000. That would have softened the residual effect on boat builders, said Hughes' aide Mark Brown.

Now with the 10 percent tax a certainty, manufacturers have begun searching for ways to overcome the predicted adverse impact on business

For instance, Viking Yacht Co in New Gretna, builder of boats ranging in price from $250 000 to $2 million, will concentrate more on the international market in an effort to double its sales in Europe and Japan, said Andrew Davala, the company's director of personnel

"We're hoping there may be some way to compensate for the luxury tax," he said

SEASIDE HEIGHTS, NJ
REVIEW
—W. 8,000—
MONMOUTH-OCEAN METRO AREA



New Boat Tax Will Depress Boating World

A few weeks ago I reported about the impact the $25 decal or use tax that was part of the Congressional budget package will have on the boating industry. This information was made available to me by the N.J. Marine Recreational Fisheries Coalition.

Now that the budget package has been passed, the boat tax has been established, since it was part of the package. What effect will the tax have on an already depressed industry? It is feared that 8,000 jobs will be lost according to sources at National Marine Manufacturers Association. The tax revenue on the payroll of the unemployed workers will equal or exceed the anticipated new tax. So you ask, why impose new taxes if there will be no plus to the federal budget? Your guess is as good as mine — "No common sense!"

The above mentioned 8,000 jobs that are feared to be lost are only a drop in the bucket when compared to the 100,000 jobs lost over the last two years. It has been that long since the boating industry has experienced the "leak in the bilge."

The NMMA reports that boat owners are the source of $112 million each year from federal fuel taxes. This money goes to the support of the U.S. Coast Guard, state fish and wildlife services, and state boating safety services.

The $25 use tax is for boats 16 feet and as the boat length increases so does the tax, up to the present maximum of $100.

New Jersey boaters have had to pay the state sales tax, state registration fee, excise tax, and now the use tax. How much money are boaters supposed to have? Yes, many boat owners are very well off financially, but 80 percent of United States boat owners make less than $50,000 per year.

Why pick on the boating industry? No other sports-related activity is having its anchor line cut. This action could be compared to imposing a use tax on every person that attends a football, baseball, soccer, hockey, tennis, or golf event, because they used some federal service to get to the game site. Maybe I shouldn't mention this because someone may get the idea to do just that.

COURIER-POST

CAMDEN, NJ
SUNDAY 101,274

NOV 25 1990

1100 Burrelle's XF

Raising revenue will burden boaters

By CARL STEVENS
For the Courier-Post

8467

Outdoors

Boaters should get ready to dig a little deeper since the recently passed federal budget, in an effort to raise capital, makes owning even a small tub expensive.

The federal coffers are expected to increase by $200 million from the pockets of recreational boat owners through a webwork of unprecedented new taxes and fees. It's also earmarked to cut expenses by some $240 billion over a five-year period.

On Jan. 1 boaters will be faced with an annual user fee of $25 to $100 per boat, depending on length, which is expected to raise some $130 million. A 10 percent luxury tax on boats costing more than $100,000 will raise another $20 million.

The nickel-per-gallon increase in the federal gas tax will take another $50 million per year out of the pockets of boaters.

The new user fee tax will be assessed annually by length as follows: $25 for boats 16-19 feet; $35 for boats 20-26 feet; $50 for boats 27-39 feet and $100 for boats over 40 feet. Failure to pay the user fee tax could result in a fine of up to $5,000.

The boat user fee deal was engineered by Rep. Leon Panetta (D-Calif.), Sam Gibbons (D-Fla.) and Bill Frenzel (R-Maine) over the objections of the House Merchant Marine Committee. The committee, which has jurisdiction over the Coast Guard, has opposed boating user fees for the past 10 years on the grounds that such user fees would be assessed simply because someone owned a boat; not because he actually used any government services.

Recreational boaters already pay over $125 million per year to the federal government on motorboat fuel taxes to fund all programs which benefit them.

The legislation also specifically states that, even after a boater has paid a user fee, it doesn't translate to more or better services by the federal government. The responsibilities to small boaters by the Coast Guard have diminished recently, but boaters are still expected to pay more for less.

The legislation states, "The collection of these charges or fees does not constitute an expressed or implied promise by the United States to perform any service or activity in a certain manner or to provide any service at a particular time or place."

Boaters probably will be required to buy a sticker at local post offices, and enforcement by the Coast Guard is expected to begin in the Spring of 1991.

The fate of boating user fees was sealed in Congress during the long debate over the budget deficit, fueled by a desperate need on the part of the members of the House and Senate Budget committees to raise revenues. Last month, the Senate Commerce Committee, chaired by Sen. Fritz Hollings (D-S.C.), along with Sen. Ted Stevens (R-Ark.), gave in and produced legislation giving the Coast Guard a blank check to raise revenues.

The National Maine Manufacturers Association estimates that the excise tax, part of a larger luxury tax provision, will affect between 10,000 and 15,000 boat units — and the user fee will affect another 4.5 million boats.

The tax will create a window of opportunity for near-term buyers, and anyone planning to buy a new boat should do so by Jan. 1.

In general, a sale will be considered to occur upon the passage of title, not when the sales contract is written, or even when the purchase price is paid. The tax does not apply to items purchased pursuant to a contract that was binding on the purchaser on or before Sept. 30, 1990.

The 10 percent excise tax is imposed on the portion of the retail price of boats above $100,000. Exempt are vessels used exclusively in a trade or business, except when used for entertainment or recreation purposes.

The anti-abuse rule will prevent businesses from using items subject to the tax in their trade or business and then selling them (or converting them to personal use) within two years as a way of avoiding the tax.

You also cannot buy components to build a boat, since purchases would be aggregated for purposes of the tax. Installation of any part or accessory on boats costing above $100,000 within six months of the date the boat is first placed in service, will also be taxed at 10 percent of the price of the part and its installation.

Discussing what it would take to fight these taxes in the coming year, a NMMA spokesman pointed out that boaters were not the only ones displeased with the budget package, since the House only approved this bill by a vote of 228-200 and the Senate 54-45. Members of the House and Senate are talking of revising the deal when the next Congress convenes in January.

SUNDAY STAR-LEDGER

NEWARK, NJ
SUNDAY 668,614

NOV 11 1990

1670 BURRELLE'S

Taxes taking wind out of owners' sails

8407

The "freedom" to sail the seas we took for granted for so long is about over. It started this past July with the Federal Communications Commission instituting a $35 fee for the boat's ship station license. Originally, this license was free and merely a piece of paper known as FCC Form 506 that the boat owner filled out to register his VHF radio and receive a set of call letters.

Very few recreational boatmen use their call letters these days, even though the law requires them to do so. Now, not only do we pay to use the radio, but if the Coast Guard boards your vessel, they will ask to see the license. Non-compliance could result in a warning from the FCC, or a fine up to $1,000. Talk is cheap no more.

Then there's that ugly ploy known as "user fee," a tax on boats from 16 feet on up. The tax starts at $25 for boats 16 to 19 feet, and works upwards to $100 for boats over 40 feet. This tax deal squeezed through with the help of representatives from California, Minnesota and Florida. Not surprisingly, these states rank two, three and four respectively in state boat registrations. Since New Jersey ranks 24th on this list, we have no clout at all.

THE REAL SHAME of this tax is that none of the revenue collected is ever likely to be returned to boating for safety, maintenance of the waterways, or boating education.

Then there's the "luxury tax" that looks to tack on another 10 percent to the cost of boats which sell for over $100,000. The crime here is that this tax affects much more than the people who buy these boats. It cripples the work-force of the boating industry that actually manufactures these yachts and supplies the boatbuilders with the materials.

The boating industry has seen very soft sales for the past two years. The National Marine Manufacturers Association points out that as many as 8,000 people would lose their jobs in the marine industry because of the "luxury tax." The payroll taxes that these workers lose effectively cancels any tax benefit the "luxury tax" might generate.

Lastly, let's not forget the price of gas and diesel fuel these days thanks to the crisis in the Middle East. But fear not, a new federal tax of a nickel per gallon will be added to fuel prices so the government can gain another $50 million per year to waste away.

KIND OF MAKES you feel like the government doesn't want you to have a boat. Fat chance of that happening. My friends work hard to keep their boats. They work hard so when the weekend rolls around, they can put their toils behind them and enjoy fresh air and fishing and water skiing and cruising and sailing and being with their families on open water. The past election has pointed out to various smug politicians that people really do care about how their tax money is spent. And even if these elected officials run around with no direction, like a boat without a rudder, sooner or later they will either be aground, or out of gas.

In the meantime, there are some bright notes to consider. The "luxury tax" won't go into effect until January 1991. It really is a good time to buy a big boat considering dealer inventory and attractive pricing. Used boats are likely to [illegible] performance in the boat market in the very near

RECORD

HACKENSACK, NJ
DAILY 161,969

THURSDAY
NOV 1 1990

64 BURRELLE'S XD

Boaters lose in U.S. budget battle

8407

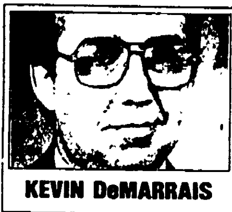
The budget battle of Washington is finally over and the result is mixed for recreational boaters. There's old news, good news, and bad news for boaters compared to the budget summit compromise early last month.

The old news is that the 10 percent luxury tax on boats costing more than $100,000 remains as originally planned, with the tax assessed only on the part of the cost exceeding $100,000.

The good news is that the gasoline tax, originally projected to increase in three steps to 12 cents, will go up only a nickle. That will coast boaters an additional $50 million annually, but is not as big a hit as it might have been.

For many boaters, the good news will be outweighed by the bad — the long dreaded user fees will become a reality and at substantially higher levels than those contained in the original budget agreement.

The summit proposal contained across-the-board $25 Coast Guard user fees, but the final plan calls for a four-step fee, based on length of boat. Boats 16 to 19 feet will be assessed an annual $25 fee, those 20 to 26 feet will pay $35, 27 to 39



KEVIN DeMARRAIS

BOATING

feet $50, and 40 feet and over $100.

Failure to pay the fee could result in a fine of up to $5,000.

According to the Boat Owners Association of the United States (BOAT/U.S.), which lobbied extensively against the increases, the new fees will cost boaters $130 million annually.

"Recreational boat owners are already paying their fair share and are willing to pay for any direct government services, but this is nothing less than a new tax masquerading as a user fee," said Richard Schwartz, president of the 375,000-member association.

Schwartz said his group, which has been working against a user fee for more than 10 years, will not abandon its fight.

"While we have lost this battle, the war over user fees is far from finished. It's going to take the government months to implement this plan and BOAT/U.S. will go to the mat early next year in Congress to challenge this gross inequity."

Many of the changes made in the budget package were the result of public pressure on legislators. That's why the gasoline tax rise was as small as it was. Because there was public sentiment to tax the rich, luxury boats became an easy target.

The user fee proposal received little attention in the budget process. As a result, there was little opposition when it was originally proposed and little when it was increased. With Congress looking for any source of funding, the user fee became a reality.

According to the National Marine Manufacturers Association, the user fees will actually be "revenue neutral" for the government because it will result in a drop in sales, meaning less sales tax, and the loss of jobs, meaning less income tax.

"The luxury fees will cost 8,000 jobs," said NMMA spokesman Grer Proteau. "We're unhappy about losing more people to a largely symbolic gesture to tax the rich. This comes at a time when we've already lost 100,000 jobs over the last couple of years."

Proteau, speaking from NMMA headquarters in Chicago, said boaters who have a valid contract as of Sept. 30 will be exempt from the new tax, as will those who take title before Dec. 31.

"We don't know how a used vessel taken in trade will be treated, if it will reduce exposure," he said.

• • •

The largest yacht match racing event in the world, the Omega Gold Cup, ends its eight-day race Sunday in Hamilton, Bermuda. The regatta boasts yachting's oldest match racing trophy, the King Edward VII Gold Cup.

Although the exclusive domain of Bermuda since 1937, the Cup was originally given by England's King Edward VII to the 1907 Tri-Centenary Regatta at Jamestown, Va., honoring the first permanent English settlement in America.

TRENTON, NJ
TIMES
D 75,682—S 89,042
TRENTON METROPOLITAN AREA

SEP 23 19..

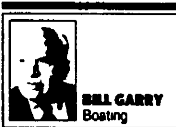
Marine Manufacturers president describes industry losses

WASHINGTON — The good news for the recreational boating fraternity is that a bipartisan Congressional Boating Caucus exists here on Capitol Hill. Among the members of the caucus from New Jersey are Reps. Dean Gallo (R-Parsippany), William Hughes (D-Ocean City), Robert Roe (D-Pompton Plains), and James Saxton (R-Southampton).

The bad news was what members of the caucus heard from the "big guns" of the recreational boating industry and members of boating consumers organizations at Tuesday's initial meeting.

The hearing was called because of the federal luxury tax and fee increases proposed to be inflicted on recreational boaters as part of the deficit reduction package being discussed by the administration and congress.

The opening testimony was delivered by Jeff Napier, president of



the National Marine Manufacturers Association (NMMA), a trade group that includes many New Jersey boat builders and manufacturers of marine products in its membership.

Napier compared today's sad state of affairs in the boating business with 1988 when the industry hit an all-time high record in sales and employment. The 1988 figures found sales and services totaling over $18 billion with over 750,000 boat units sold and employment at almost 600,000, full and part time

NAPIER WENT on to point out that sales declined about 15 percent in 1989 and another 27 percent in 1990 for a cumulative 42 percent. The net result being massive layoffs and plant closings in the industry and some business failures at both the manufacturing and retail levels. Napier pointed out that the worsening business conditions have resulted in the loss of the better part of 100,000 full-time jobs in the last 24 months.

Stressing that the purchase of boating products is sensitive to price and the existence of discretionary income, Napier said, "80 percent of U.S. boat owners have a household income of less than $50,000 a year and 60 percent have a household income of less than $35,000 If the boating industry was dependent on the purchase of luxury yachts by wealthy individuals there would be no boating industry as we know it in the U.S. since only 2 percent of annual unit volume falls into this category."

Napier continued, "In most cases the net revenue yield from taxes is less than, or at best, the revenue loss from reduced sales activity, reduced employment payrolls and reduced corporate profits. Further taxes on boating would amount to a tax on the wind because additional taxes would be the straw that forced many companies out of business altogether which, obviously, results in no tax yield.

The next witness to testify was Charles Strang, chairman of the board of Outboard Marine Corporation (OMC), the world's largest manufacturer of outboard motors and the second largest manufacturer of recreational boats. Strang pointed out that his company employs over 9,000 workers and has 5,000 dealers — an organization that extends into every congressional district in the country.

Strang revealed that since its founding 64 years ago, and through fiscal 1989, OMC never lost money. However, through the first nine months of fiscal 1990 OMC has reported a loss of $34 million after-tax dollars.

Strang went on, "We have reduced our U.S. salaried and hourly work force by more than 1,400 employees in the third quarter alone... Since last October we have closed three boat manufacturing plants, an office facility, three retail stores and an outboard motor assembly plant."

GETTING DOWN to the nitty-gritty, Strang said, "We are looking at an industry that is severely depressed, which is why it is so important for you members of Congress to know our situation. Even the present talk of new taxes on our products can only make our situation worse. Such taxes would not raise additional money for the government, they would only reduce our present level of sales, thereby reducing whatever the government is getting now. This is something we know from history."

From those representing the retail facet of recreational boating, the caucus heard Phil Keeter, executive director of the Marine Retailers Association of America relate that the declining boating business has resulted in the average employment of retailers in the boating sector dropping from seven to five. Mick Blackistone of the Marine Trade Association of Maryland said business across the board, from dealers to fishing charters, has decreased materially.

Bill Garry is Times boating columnist

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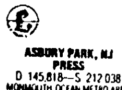

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NOV 4 199

Prediction: 8,000 workers will lose jobs over boat taxes

National Marine Manufacturers Association president says result not worth loss to workers

The boating community is howling about the new boat taxes passed as part of the budget package by Congress.

Jeff Napier, president of the National Marine Manufacturers Association, predicts that 8,000 workers will lose their jobs as a result of the tax on pleasure craft exceeding $100,000

"It is a dumb idea that misses the revenue raising target altogether," he said.

"Payroll taxes paid by those 8,000 laid off workers cancel out the estimated tax yield," Napier said, pointing out that the boating industry has already lost 100,000 jobs due to a sector-specific recession that began two years ago.

"Many on Capitol Hill know it (the tax) won't generate revenue," he said. "Excise taxes are by their nature regressive, and it's ultimately the hard working people in the boat building industry who will pay this tax with their jobs."

The U.S. boating industry is one of the few manufacturing industries in America to have a favorable balance of trade — about $1 billion of exports annually

"Our price competitiveness abroad is the result of our volume efficiencies in the U.S. market. The excise tax will reduce our sales volume, cost efficiencies and pricing advantages on the very boats which lead our exports," he said

According to industry statistics, 80 percent of U.S boat owners have household incomes of less than $50,000 a year. Sixty percent make less than $35,000

Napier stressed that boat owners receive no special or free treatment from

federal and state governments, and they already contribute $112 million annually in federal fuel taxes that pay for Coast Guard and state boating safety services and state fish and wildlife services.

In New Jersey, boat buyers also pay a sales tax on the purchase of their boats and a state registration fee

On Oct. 27, Congress dropped another load on the boater in the form of the boat tax, which begins at $25 for a 16-foot boat and progresses to $100 for large boats.

Rep. Frank Pallone Jr., D-N.J., has vowed to continue his fight against the tax by introducing a bill to cancel the tax.

John Tiedemann, chairman of the New Jersey Marine Recreational Fisheries Coalition, said that group is solidly opposed to the $25 tax on boats sharing federal waters

State Assemblywoman Marlene Lynch Ford, D-Ocean, and Assemblyman John Paul Doyle, D-Ocean, both realized the harm the tax would do to boating interests and introduced AR-99 opposing the measure

Tiedemann said the coalition is opposed to any new taxes that will not benefit boaters and are not a dedicated fund

"If the new taxes were designated for boater safety and environmental programs instead of being applied to the general fund, it might be acceptable," he said

"However, the federal government is proposing an additional tax on boaters and providing less services"

He pointed out that the boating industry is the only sports-related activity to be heavily targeted for increased taxes by the federal budget.

■

Opposition to the stocking of sea-run salmonids in the Delaware River is more widespread than assumed

According to a story by Robert Brunisholz, writing in the current issue of New Jersey Federated Sportsmen News, it appeared the majority of persons attending two state hearings on the proposal were against the introduction of salmon and steelheads in the river

Some anglers supported the introduction of new game fish, such as those found in Lake Ontario and New York rivers, but most felt it would hurt their trout fishery

The New Jersey Federation of Sportsmen and the National Wildlife Federation has come out in support of the state Division of Fish, Game and Wildlife's idea to stock the Musconetcong River with young salmon and steelhead trout that would establish populations in the future

■

The Northest Fisheries Center at Woods Hole, Mass., has announced that there is a huge supply of Atlantic mackerel in New England and Mid-Atlantic Bight waters, and government personnel are trying to find methods to better preserve and market the fish

Mark Perlsweig of Oceanport holds a striped bass of 57 pounds, two ounces he caught Friday night.

The government feels that the mackerel could stand a harvest of 880 million pounds next year, but combined domestic and foreign harvest has been less than 165 million pounds

■

Jack Cathcart has been elected commodore of the Beach Haven Marlin and Tuna Club. Other officers elected were Bill Hulse, vice commodore Allen Harrigan, rear commodore; Bob Tait, treasurer, and Ken Hinekorn, secretary

■

Ocean City Beach Buggy "B" team won the Delaware Valley Surf Anglers tournament at Sea Isle City

The Ocean City team scored 66½ points to beat 20 other clubs. Anglesea Surf Anglers placed second with 65 points and the Merchantville Fishing Club came in third with 61¼ points

The largest fish was a 35¼-inch bluefish caught by Dana Sannalis. John Long of the Jersey Rod and Reelers caught three fish and scored 40½ points to win the most fish category

■

The Spring Lake Live Liner Fishing Club will nominate new officers at 8 p.m. Thursday at the Spring Lake Heights Community Center

☐ John Geiser is outdoor editor of the Asbury Park Press

HOME NEWS
NEW BRUNSWICK, NJ
DAILY 59,335
WEDNESDAY
OCT 31 1990

Outdoors
Rick Methot

'91 budget will swamp boating

The adoption of the federal budget plan has given boaters and boat manufacturers that sinking feeling.

That's because the tax package would hike user fees, slap a 10 percent surcharge on expensive boats and boost the price of gasoline. Oars never looked better.

It's no secret the boating industry is foundering, and it's been taking on water for the past couple of years. Like most other big-ticket sales, things were booming in the heady mid-1980s. But when the country finally woke up to an unbalanced checking account, something had to give and big boats sunk on the list of life's priorities.

If things get much worse people who like to float on water will go back to inner tubes. The National Marine Manufacturers Association doesn't mince words, salty sorts that they are. The organization says a luxury tax on recreational pleasure boats is "a dumb idea that misses the revenue-raising target altogether."

The tax would add 10 percent to the cost of boats with a $100,000 or more price tag. It might be tough for most of us to turn a sympathetic ear to the wail of the well-heeled, but according to a Newhouse News Service report, New Jersey is one of the nation's leading producers of expensive boats. No sales, no jobs. Adding to the problem is that in any recession, cash is king. How to get cash? Sell the boat. That means, no doubt, more boats than buyers. A boat glut.

NMMA president Jeff Napier says that 8,000 workers would be laid off as a result of the plan. "Payroll taxes paid by those 8,000 workers cancels out the estimated tax yield," he said. Napier also pointed out that 100,000 industry jobs have already been lost due to the recession. He went on to say, in a press release to outdoor writers, that the boating industy is one of the few in America to have a favorable balance of trade, about $1 billion in annual exports.

"Our price competitiveness abroad is the result of our volume efficiences in the U.S. market. The excise tax will reduce our sales volume, cost efficiences and pricing advantages on the very boats which lead our exports. This helps illustrate the foolishness of the proposal."

Industry statistics claim that 80 percent of U.S. boat owners have household incomes of less than $50,000 and 60 percent less than $35,000, but contribute $112 million annually in federal fuel taxes which pays for Coast Guard and state boating safety practices and state fish and wildlife services. In addition, most states charge boat owners sales tax on purchases and mandate registration fees. New Jersey is one. More lenient laws elsewhere is why you see so many Delaware-registered boats ... and Vermont registered vehicles ... in New Jersey.

That's the big-ticket stuff. Nowwhat about the $25 annual tax for the rest of the crowd. It starts with 16-foot boats. Not too many anglers or recreational boaters dare put a craft in the ocean less than that measure. For a boat more than 100 feet in length the tax could be $100.

The New Jersey Marine Recreational Fisheries Coalition is naturally opposed to that. Part of the gripe is that the money raised is hardly dedicated to anything that will benefit boaters.

Is there any other sports-related activity getting so hammered? Name one. Do owners of professional baseball

See BOAT, Page C3

BOAT

Continued from Page C1

or football teams have to explain a 10 percent surcharge on ticket sales? Nope. Do they raise prices? Yep.

And finally, it's going to cost more to own a power boat because of the inflated gasoline prices. The millionaire larking about the ocean is one thing, but when it costs more for the party or charter captain to run the operation, guess who's going to take up the slack? The commercial waterman faced with increased costs will pass them on too. Same goes for any businessman depending on a boaters for a living.

A sad note

Regular readers of this column know we cover Pennsylvania, simply because so many New Jersey residents go west to fish and hunt there, especially during the two-week buck season.

And much of the information that has appeared here regarding deer hunting especially has been with the input of Ted Godshall. He was the chief of the state's public information division for the state Game Commission. He died last week while attending the fall meeting of the Pennsyvania Outdoor Writers Association, a fatal heart attack. He was 58.

In the scores of times I phoned Ted for information regarding this column he was always a good and reliable source of information. We disagreed on some points of Pennsylvania deer management, but Ted was a man who returned phone calls with the information sought; there's not much more that makes such a man a "good guy" in the mind of any reporter. Rest in peace, old friend.

In the salt

Joe Cianci of Bordentown, who does tend to be creative with a ruler's measurments when it comes to fish, says bluefish were hitting well on cut mullet off Belmar Jetties this week. Two to five pounders were common, although no bass showed up to make things interesting that day. The shore right now? No tourists, no clogged beaches.

Greg Bogan claims blackfishing is hot at the Point Pleasant Canal. Fish a slack tide with fiddler crabs.

Some winter flounder are being caught in the Manasquan, use blood or sand worms and chum with clam or mussel. Nightcrawlers will do in a pinch.

BRIDGETON EVENING NEWS

BRIDGETON, NJ
DAILY 14,000

SATURDAY
OCT 27 1990

131 BURRELLE'S

Boatin' With Beecroft

By RICHARD BEECROFT

While we admit that the money has to come from somewhere to pay the nation's bills, we think that the small amount (small when talking budget figures) that would be raised by a luxury tax on boats would not be worth the damage that it could do.

That may sound like the old "not in my backyard' syndrome, but according to Jeff Napier of the National Marine Manufacturers' Association, while the tax on boats valued at over $100,000 would bring in only a nominal sum it could cause the loss of about 8,000 jobs in the boat manufacturing industry and associated fields.

"It's a dumb idea that totally misses the revenue raising target altogether", Napier says, adding that losses wouldn't only be limited to boat builders but would pass on down to marinas and suppliers who are already suffering from a business downturn.

The proposed 10 percent tax on luxury boats would have to be born by the buyer and that would put American builders at a disadvantage with foreign companies. The U.S. at present has a favorable trade balance in the boating industry and the tax would jeopardize that advantage, Napier believes.

Another even less popular fund raiser suggested is the imposition of a $25 per boat users fee that would take more money from the boating public. That fee, too, could hurt the industry. But, the worst feature of the proposal is that the so called user fee would not go for use by the Coast Guard or the National Park Service that provide services to some boaters. It would go into the general fund.

New Jersey boaters are already taking some action to oppose the fees (which have been proposed before and defeated) and are petitioning Congressman Bill Hughes who is a member of the House Merchant Marine Committee. The fee should be opposed because it is not a fair charge to boatmen and it wil; further burden an already highly taxed recreation.

New Jersey boat registrations have fallen in recent years and the recreational boating industry is in a slump with some marinas closing and others, for the firsttime inyears, having vacant boat slips. That economic situation can only be worsened by the added $25 fee.

The fee is being oposed by both commercial and recreational boating groups but should also be opposed by tourist organzations as boating and fishing, that depends on it, are two of the major tourist attractions of the state.

There are, of course, many wealthy boat owners, those with large luxurious boats known as yachts (technically, every pleasure boat is a yacht) but most American boat owners are ordinary working people. Statistics show that about 80 percent of boat owners are from families with under $50,000 annual income and of them about 60 percent have incomes of less than $35,000 annually. Most are not "fat cats".

In New Jersey and many other states boats are already subjeect to sales taxes and registrationn-fees and every piece of equipment boatmen use is also taxed by the state, the federal government or both.

I don't think that putting a "users fee" on boats is any more fair than putting it on bicycles or riding horses or any other kind of recreational equipment.

You can tell your congressman, Bill Hughes, by writing him at home: 222 New Road, Linwood, N.J. or calling him at 609-927-9063. Tell him what you think.

******

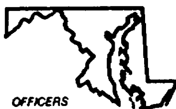
Tax threats may or may not have anything to do with it, but at the Annapolis Boat Show I noticed a decided increase in the number and variety of very small boats on display. Both in power and sail, there were a great many boats in the under 15 foot class. All were trailerable and many were light enough to be car-toppers. Many of those displaying the small craft were individual builders or operators of small shops, but all exhibited remarkably crafted merchandise.

There were still hundreds of the biggies for world cruising or 'round the world racing, but we were told by one salesman for a 54-foot ketch that there were a lot of "lookers" but sales were off.

Maybe the fact that those "yachts" or any boat big enough to be lived in can no longer claim tax deductions as a second home makes a difference. The interest on a mortgage for a boat worth more than $100,000 makes a substantial deduction.

******

If you were planning on taking a Saturday afternoon or Sunday boatride down the Cohansey River from Bridgeton's waterfront, forget it until next Spring. Howard Zwicker tells me that tomorrow he has a charter for the trip and that is the last one for the season. Plan on it for next year. It's fun and informative.



Marine Trades Association of Maryland, Inc.

"Working Together For The Marine Industry"

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Written Testimony
S 649
Senate Finance Committee
June 12, 1991

Mr. Chairman and members of the Committee, I am Mick Blackistone, Executive Director of the Marine Trades Association of Maryland, which works with approximately 1,500 recreational boating businesses throughout our state. I am submitting this written testimony in support of S 649 which would repeal the new luxury/excise tax on vessels costing more than $100,000.

As you well know, the marine industry in this country is facing the worst depression in its history. While we can, of course, blame some of this slowdown on the recession comparative analysis of units of boats sold and sales figures illustrate clearly that the new luxury tax on vessels has been a dramatic blow to our industry. It has cost us thousands of jobs and, in the past six months, over fifty small boating businesses have closed their doors. This trend is continuing and will continue.

The luxury/excise tax in combination with local and state taxes aimed at wealthy rich boaters or the "fat cat" have not panned out as the wealthy have decided not to use their discretionary dollars on boating and the result has been devastating to the blue collar worker, the middle income professional and the small business owner. A recent survey of thirteen of our large boat dealerships has revealed that sales are off over 55 percent in the first quarter of 91 compared to first quarter 1990 and employment is down over 40 percent. Not to mention the lost ancillary revenues the state and local communities would receive due to boat purchases if they would take place.

While we recognize that state budgets are in terrible shape and that Congress has budget deficit reduction responsibilities too, small business and our manufacturers cannot carry this burden and the average citizen cannot carry this burden. Government should look for incentives to promote business and increase the tax base rather than leave it up to us to figure out how to meet our taxation, regulation and legislative responsibilities with a shrinking customer base. Frankly, many of us don't know what to do anymore!

The Marine Trades Association of Maryland is asking you to take the initiative through passage of S 649 to begin to turn this situation around. We will be happy to work with you in any way possible. We are, in fact, depending on you because, without sounding melodramatic, the fate of many of our businesses is

in your hands. By way of example, Dickerson Boatbuilders, a 45 year boat building tradition on the Chesapeake's Eastern Shore of fine custom sailboats filed for bankruptcy one month ago. It will probably end up in auction. The luxury tax must be repealed so that we can inspire purchases and stop this trend among our nations boat builders and the trickle down effect which is causing other service companies to close.

Maryland and the famed Chesapeake Bay no longer has a boat building industry...with the closure of Dickerson we will rely on others who manage to hold on. Now, consider some of our long time dealers:

Dealer	Item	Number	Value
Oxford Yacht Agency:	Units sold 1st Quarter 90	5	= $2.2 million
	Units sold 1st Quarter 91	0	
	Loss of employees	8	
Harrison Yacht Sales:	Units sold 1st Quarter 90	7	= $1.8 million
	Units sold 1st Quarter 91	0	
	Loss of employees	38	
McDaniel Yacht Sales:	Units sold 1st Quarter 90	13	= $1.2 million
	Units sold 1st Quarter 91	1	= $120,000
	Loss of employees	8	
Chesapeake Yacht Sales:	Units sold 1st Q 90	7	= $4.3 million
	Units sold 1st Q 91	0	
	Loss of employees	7	
Annapolis Yacht Sales:	Units sold 1st Quarter 90	7	= $1.1 million
	Units sold 1st Quarter 91	2	= $240,000
	Loss of employees	6	
Shady Oaks Yacht Sales:	Units sold 1st Quarter 90	8	= $1.3 million
	Units sold 1st Quarter 91	1	= $107,000
	Loss of employees	4	

We hope that you will consider these businesses and their colleagues and vote for S 649.

Thank you.

Prepared Statement of Everett A. Pearson

My name is Everett Pearson, President of Tillotson-Pearson, and I have been in the boat business in Rhode Island for the past 34 years. I am here representing three marine related organizations, ASAP, a group of 150 marine related businesses, Bristol Sailing Industries, an association of boat manufacturers, and the Rhode Island Marine Trades Association.

I co-founded a company called Pearson Yachts in 1957, which we sold to Grumman Aircraft Corp, and started our present company in 1966. We manufacture 3 lines of boats. J Boats, high performance racercruisers, from 22' to 44', priced from $15,000 to $300,000, and Alden Yachts, custom built expensive yachts that range in size from 44' to 54' and priced up to the $800,000 range. These two lines are high quality products that were both recently picked by Fortune magazine as two of the 100 best made products in the United States. The third product line is manufactured under a joint venture agreement with one of the largest boat manufacturers in France, Jeanneau. These boats are 42' cruising catamarans, selling in the $350,000 range. We also manufacture a swimming exercise machine called SwimEx, wind generator blades for a California company called US Windpower, and fiberglass bus bodies which mount on Peterbilt truck chassis.

I have been involved in this industry a long time and have been through many business cycles. I majored in Economics at Brown University, so I understand the workings of the markets and the business world.

Let's concede right off the bat that yachts make an alluring and seemingly logical target for a luxury tax. Yachts epitomize the public's concept of excess wealth and luxury, and everyone will agree that anybody who can afford to pay two or three hundred thousand dollars for a yacht, can certainly afford to pay a tax on his indulgence. *The problem is that this tax cannon aimed so righteously at the rich, has missed the rich entirely, and instead has exploded directly among the ranks of the blue collar men and women who actually build the yachts.* The impact has been sudden and catastrophic, resulting in—not just a slowdown, but a complete stop in the purchase of American built yachts. This government inflicted blow has brought every U.S. boat builder to the financial brink, and forced the layoff of thousands of workers—while at the same time not contributing one cent of increased tax collection. It is this multiplicity of bad effects, and total absence of good effects that makes this tax so unjustifiable.

In retrospect it can be seen that the rich yachtsman who was the target of this exercise had three very simple options:

1. To postpone or cancel purchase.
2. To purchase a used yacht from the abundant supply currently available.
3. To purchase overseas and register in places like the Bahamas which have now legislated special sanctuaries from this new U.S. luxury tax.

Any one of these options are disastrous to the American builders and workers to whom new boat sales are life blood. Let me review and assess the extent of the damage that is clearly attributable to the imposition of this luxury tax.

In the middle 70's and again in the mid 80's we had a slow down in business and our small boat sales volume fell off rapidly while the expensive line of boats continued to sell. High priced yachts proved to be recession proof and continued to sell. Most recently in 1989, when our inexpensive boat sales slowed considerably, we sold 19 J44's, (retail about $325,000), in 1990 we sold 24, but since this tax went into effect we have only sold two of these boats into the United States market. Because of the relatively weak U.S. dollar, our sales overseas have picked up, and 6 boats have been sold.

As our products became competitive in the international market last year, we planned on this extra volume to maintain profits in 1991. Along comes this tax, destroys the domestic market, volume falls dramatically, and 84 people have been put out of work.

In 1989 we sold 8 high priced Alden sail boats ($450,000 to $800,000) and 7 more in 1990. Since this tax was imposed, we have sold 0 of these high priced recession-proof products, and 52 people have been put out of work and on to unemployment rolls.

Ted Hood's Little Harbor Custom Yachts, in Portsmouth, RI has sold an average of 12, high quality, high priced boats per year for the last four years. These yachts average between $500,000 and $3,000,000 each. Since the end of last September, the deadline for ordering to avoid the tax, he has not sold a boat.

Ted Hood also reports that his Black Watch power boat division has been selling a few small boats, but he has not sold any of the $200,000-$400,000 large boats since the first of the year. Over 24 production workers have been laid off in this division.

Hood Yacht Systems, building equipment for large sailboats, has seen an increase in their foreign sales of 40%, but their domestic sales are down by 50%. Thirty percent of their work force has been laid off.

Little Harbor Marine, which does service and commissioning work, anticipates a reduction of about 30% in its work level this year.

In summary Ted expects to see his business in these four companies off 40% and a reduction in his work force of about 40%. This does not take into account the numerous small businesses in the area that do sub-contract work and are effected as well. Ted reports that this means he will lose money this year and will be looking for a refund, instead of paying taxes. In addition, many employees instead of earning money to pay taxes, will be on unemployment or welfare benefits.

Many customers have told him that when you add up state taxes and this federal tax it pays to buy the boats overseas and commute to where the boat can be moored tax free. It's a lot more fun traveling to these areas than paying taxes here.

Ted Hood says, that if you sum it all up, there will be much more lost in the economy than can be gained from this tax. The suffering of laid off employees will be great, and we will lose productive capacity.

He states that some of the European companies, i.e. Italy years ago, found out what happens when you tax people too much. They find a way around it, and the economy goes to hell. Our country's capabilities have been slipping badly in world competition and this tax on our boating industry, that was once one of the best in the world, will cause it to fade into oblivion.

In Maine, where The Hinckley Company produces products that compete with our Alden line and Little Harbor, the results have been the same. No boats have been sold, and many people have been laid off.

Linda Dunn, who operates Marine Documentation, Inc. in Newport, RI, reports that in most years, they document between 50 and 75 new boats for the U.S. market. This spring business has been brisk on vessels being built overseas, but not a single new vessel has been documented for the U.S. market.

Here at TPI, in 1991 we have sold 5 42' catamarans, 3 into the West Indies charter fleets and 2 into the Mediterranean. We have 11 excellent prospects here in the United States all sitting on the sidelines waiting the outcome of this tax situation. No one wants to be the last jackass to pay this tax.

One thing we all know is that "capital moves," and taxes are a powerful influence to make this happen. Let's look at the wind energy industry. In the late 70's the government, in a much wiser and more positive action, voted a tax credit for capital flowing into alternate energy fields. This spurred the development of a wind energy industry to generate electrical power.

There were numerous locations in the U.S. ideally suited, with plenty of wind available, where these wind farms could be located. California in another wise business decision, offered tax credits to its residents investing in alternate energy-producing companies. Look what happened. A billion dollar industry sprang up in the state as capital flowed to take advantage of reduced taxes. U.S. Windpower, a company started in Massachusetts, moved there and now employs 500 people there.

We seem to have many legislators who think these types of tax incentives help the wealthy and have no benefits for the working man. There is no question the wealthy benefit as they invest capital and reduce their taxes. But let's look at what these California tax incentives, which spurred on the development of this industry but which were eliminated 5 years ago, did for our work force in RI.

Over the last eight years, we have had an average of 38 men working on wind blades, and over 40 million dollars of revenue flowed into the RI economy. We have produced approximately 17,000 blades for these machines and have shipped about one truckload of blades every week to the West Coast.

Our work force consists of mostly portuguese and hispanic immigrants, many of whom speak very little english and many who do not read or write. The fields of employment open to them has historically been farming, which has now disappeared in RI and southeastern MA, laboring on road or other types of construction, which has dried up over the past few years, fishing, an industry beset with it's own problems, or nursery work which is still available but seasonal. The fiberglass boat industry has been the main source of employment for these workers over the past thirty years here in southeastern New England.

This tax, intended to sock it to the wealthy boat buyer, has socked it to these boat builders. In this area of the country alone, it has put over 2000 of them on the unemployment rolls and has caused the bankruptcy of 9 companies. These workers, many from Fall River, Massachusetts, where the unemployment level is now over 19%, makes it virtually impossible for them to find other work. Their future is in the unemployment lines, and the costs associated with that far surpass any revenue

that this tax will ever generate. And where are the wealthy boat buyers? Either buying used boats, or overseas purchasing a boat, or sitting on the sidelines with their investments in tax free bonds earning income, while they await the final disposition of this tax.

In scenario, completely opposite from this one, but influenced by taxes, the French government passed a law called "Loi Pons," to encourage investments in overseas islands to develop jobs. The law allows any company paying taxes in France, or in the French islands, which invests in any French island around the world, and keeps the investment in place for five years, to deduct 100% of the investment as soon as it is made, from their taxable revenues. They are then allowed to deduct operating expenses, associated with these investments, against income over the next four years.

This allows French boat builders, Beneteau and Jeanneau, to dominate the sailboat industry worldwide. They have been producing approximately 400 large boats per year for charter companies that operate from Turkey to Tahiti. The Beneteau factory in North Carolina is presently busy turning out products for the charter fleets in the French West Indies under this law. Thousands of jobs were created in France and many more in the West Indies. It has enabled French companies to dominate the yacht charter business, as they now control over 70% of this market.

Our company, because of our joint venture with Jeanneau, has orders for five 42′ catamarans. Three are destined for the West Indies and two for the Mediterranean, all sold to investors under this French law.

Two months ago we were contacted by a European charter fleet operator who wanted to know if we could build three 65′ sailboats and guarantee delivery before the end of this year. They have French buyers ready to purchase these boats, but there are no more available in Europe, as the companies producing these large boats are sold out. Quite a contrast to the condition of United States boat builders.

There has been sales activity on the brokerage level that several firms report is the best it has been in several years. This means that people are still buying boats; used boats that don't employ people and where they can avoid taxes. Interyacht, a brokerage firm in Annapolis, MD, reported that March was the best sales month that they have had in 25 years. This activity shows that, despite the recession, boats are selling and that this tax is the culprit killing new boat sales.

Speaking primarily about our area of the country, New England, which had been devastated by the recent recession, this tax is the coup de grace to one of its oldest industries. Over two thousand workers have been put on the unemployment roles as builder after builder succumbed, to either the recession effecting small boats, or the lack of demand for large boats which this tax quickly inflicted on them.

New England bankers, paying for the sins of their gross mismanagement over the past few years, are desperately trying to put their houses in order in a hurry, and are compounding the industries problems by severely restricting credit. This applies to buyers, seeking retail loans, dealers, looking for floor plan money, and manufactures needing working capital.

There are no large pleasure boat builders in New England. We are all relatively small businesses, struggling to survive in a hostile environment. We cope with foreign imports, high energy costs, high workmen's compensation costs, high medical costs, and yet we employ many artisans, whose skills match those of any boat builders around the world. This industry survives because there are still Americans who want to buy a first class American product built by people who carry on the heritage of our industry. Discriminating against the buyers of these floating second homes, called "yachts," by imposing this tax, is destroying this industry.

As I write this explanation of how this tax effects our industry, I wish I had the skill to explain it, in the manner that Mike Royko, the nationally syndicated columnist did, in a recent editorial on the subject. He covered it beautifully, and if you missed it, you should make it a point to find it and read it. It says it all.

The question that must be answered now, is how do we correct this dreadful error before we have totally destroyed this industry. We are here asking for your help and leadership in guiding us out of this desperate situation by doing something. If it is not politically possible to repeal this law at this time, then at least vote to postpone it, so potential buyers can go ahead with their purchases. This postponement, would then give us time to continue working for its repeal and to keep building boats while we do so. To not do anything, is letting our businesses die a lingering death and making the innocent worker pay dearly, as they suffer the consequences of this misguided tax law.

We do not understand the inner workings of our legislative process but with some guidance we are all willing to work and help in any way possible.

The thing we do understand is that there are a lot of boat builders in the unemployment lines that shouldn't be there. Let's repeal this tax and put these people back to work!

PREPARED STATEMENT OF SENATOR CLAIBORNE PELL

Mr. Chairman, I much appreciate this opportunity to testify before the Senate Subcommittee on Taxation in support of a repeal of the "luxury" excise tax on recreational boats.

At the outset I want to commend my colleague from Rhode Island, Senator Chafee, and Senator Breaux for their leadership in proposing legislation (S. 649) to repeal the recreational boat luxury tax. I am an original co-sponsor of that bill.

Mr. Chairman, the 10% excise tax on the sales price in excess of $100,000 of recreational boats was enacted last year with two objectives: to raise revenue, and to tax the wealthy.

In reality, the tax fails in both of those objectives. What the tax has produced, however, in tandem with the economic recession, is a catastrophic collapse in the recreational boat industry.

Rhode Island is one of our nation's leading producers of recreational boats, with a proud heritage of the great names in American yachting history. That industry in Rhode Island has now been devastated by bankruptcy, plant closings and layoffs. Those in the industry who face the challenge of selling motor and sailing yachts to the wealthy will tell you today that the luxury tax has played a major part in that collapse..

Mr. Chairman, I have heard not one cry of complaint from wealthy yachtsmen about the luxury tax on boats. But I have heard desperate pleas for help from those whose jobs have been eliminated or threatened by collapse of boat orders and sales. I have heard from marine architects, from shipwrights, skilled workers in wood and fiberglass, and engineers who have produced some of the world's greatest and most admired sailing vessels and who are now either jobless or fear they soon will be.

Is the luxury tax raising revenue? The best informal estimates are that it will raise less revenue than the costs to the federal government of imposing and collecting the tax.

Is the luxury tax really taxing the wealthy? Hardly. Any well-off yachtsmen who wishes to pursue his recreation can do so easily without ever paying a luxury tax. He can, for example, purchase a $500,000 yacht in England, homeport it in the Caribbean, and sail it up and down the coasts of the United States stopping in to test such waters as those of Newport or Annapolis, and he will not pay our luxury tax.

Or, a well-off person can simply decide to pursue another less-taxed recreation-buy a hunting lodge, a condominium at a ski resort, or a string of polo ponies and there is no luxury tax. In truth, Mr. Chairman, if we wish to tax the well-off we must tax their income, not their purchases.

To suggest that this luxury tax on recreational boats offsets the excise taxes imposed last year on the beer, wine, cigarettes and gasoline consumed by the average American is simply absurd.

The luxury tax on boats is little more than a symbolic gesture toward tax equity, but for the boating industry workers in Rhode Island it is symbol they can not afford.

This is a tax that raises little or no revenue and instead of taxing the wealthy imposes a crushing burden of unemployment on thousands of skilled American workers. I urge the subcommittee to approve legislation to repeal the tax.

PREPARED STATEMENT OF SENATOR HARRY REID

I would like to thank the Chairman of the Senate Committee on Finance, Senator Bentsen, and the Chairman of the Subcommittee on Taxation, Senator Boren, for acknowledging the magnitude of the source tax issue, and for permitting Senator Bryan, Bill Hoffman of Retirees to Eliminate State Income Source Tax, the Federation of Tax Administrators, and myself to come before them today to discuss a matter in which all Members of Congress have a stake—a matter in which all Americans have a stake.

A few years ago, I was approached by Nevadan Bill Hoffman, who told me about a problem Nevadans were having. You see, many Americans are retiring to the Silver State, because, among many other reasons, there is no state income tax. Bill informed me, however, that these new Nevadans were being harrassed by their

former states of residence, and were being taxed by them. Now, I've always been a resident of Nevada. I have never had another state levy a tax on my income or assets. But I know many, many people who have moved to Nevada, retirees and otherwise, who certainly never expected to be told they must continue to pay state income taxes to the state where they used to live. To be perfectly honest, I could hardly believe what Bill Hoffman was telling me.

There are Nevadans, and citizens in every state, who are forced to pay taxes to states where they do not reside. These retirees pay taxes on pensions drawn in the states where they spent their working years, despite the fact that they are not present to participate in the programs which their taxes are funding—they do not participate in medical assistance programs, senior centers, public parks, or even get to vote in their former state of residence—yet they still pay taxes to these states.

No one wants to pay a penny more in taxes than he or she has to. But most Americans pay what they owe. They pay because they know what they are getting in return, and in the United States, you get a lot in return. But you don't get a single benefit from a state in which you do not reside—except in some instances, a tax bill. As you will hear many times today, this is taxation without representation.

This practice is affecting more and more Americans as economic times become tougher, and certain states have become more creative in looking for revenues. That is why Retirees to Eliminate State Income Source Tax (RESIST), founded in July of 1988, has grown beyond the borders of Nevada to include members in every state of the Union. This is a non-profit, grass roots organization in the truest sense of the word—it operates entirely through the work of volunteers—no members are salaried. The credibility of this group has convinced other long-established organizations such as the National Association of Retired Federal Employees to make a commitment to prohibiting taxation of non-resident retirement income. This is a bi-partisan effort, of millions of Americans who cannot live with unfair reductions in the fixed incomes which their retirement provides them.

I know of people who are taxed at a rate which reflects the entire income—not just their income derived from the taxing state. An individual could find him or herself paying a tax on his pension that far exceeds the rate that would have been applicable a the time the pension was earned. He could also find himself paying tax on the same income to more than one state.

Most states offer a tax credit when their residents pay their income taxes to other states. While this allowance is admirable, the state offering the credit is LOSING REVENUES. If I retire from California to Oklahoma, and California decides to levy a tax on my pension, Oklahoma will most likely grant me a credit for the amount I owe California. But Oklahoma will still be the state providing me with medical assistance and other seniors programs, as well as access to its parks—not to mention the right to vote. And Oklahoma will be providing me all this free of charge since California will be receiving my tax dollars!

To prohibit this unethical practice, I have offered legislation which prohibits states from taxing pensions or retirement income of non-residents. States are crossing state lines, collecting taxes from non-residents, and are retreating, offering nothing in return. State residents who conscientiously pay taxes on their pension have the privilege of voting in that state, and have access to state funded social services, parks, and other amenities. Non-residents just pay.

All too frequently retirees are unaware that they must pay tax to the state from which they draw a monthly pension check. As in Nevada, many people plan retirement in state with low or non-existent income tax and spend or save accordingly. Notifications that back taxes and penalties are owed to a state other than where someone resides is rightfully met with indignation and horror. The indignation rises from the shock of post-revolutionary taxation without representation; the horror rises from the inability to pay an enormous tax debt when one lives on a fixed income.

Once more, I would like to thank the Chairman for the opportunity to discuss source tax, and I would like to urge his support for prohibiting this unfair practice.

PREPARED STATEMENT OF SAMUEL SHAPIRO

Good morning. I am Sam Shapiro and for the last ten years I have served as the Treasurer for the State of Maine. I am pleased to have the opportunity to speak with you today.

With three other very able representatives of the National Association of State Treasurers here today to give you their insights into the unintended costs and chaos that have visited state and local issuers of tax-exempt debt since the new provisions of the 1986 Tax Act have taken effect, particularly in the now infamous area of arbitrage and rebate regulations, I will focus my testimony today on another technical provision in the Code which currently denies to smaller and usually more rural issuers of debt in Maine, as well as in many other states including Texas, Indiana, New Hampshire, Vermont, and Michigan the lowest possible interest rate costs which I know is what you want them to receive.

I will propose for your consideration an amendment to the Code which will allow these generally infrequent issuers of debt the opportunity to achieve the best interest rates available to them and thus allow them to build the environmental infrastructure facilities, roads, and other public purpose facilities they must have. I believe moreover that this proposal will result in no net increase in so-called lost revenues to the federal treasury.

As State Treasurer, one of my responsibilities is to serve on the boards of all those state level agencies or authorities in Maine which are allowed to issue tax-exempt bonds. In that role, I serve for example on the board of Maine's Housing Finance Agency, the Economic Development Authority, and the Municipal Bond Bank.

For over eighteen (18) years the Maine Bond Bank has worked with all Maine local government in providing cost effective access to the national credit markets. Most of our smaller communities simply would have no access to the lower interest rates available in the national credit markets if it were not for the ability of the Bond Bank to pool these issuers together, provide state level

credit enhancement in the form of the state's moral obligation and payment of costs of issuance, and take them into the national markets as a pool. Particularly for large ticket items, such as environmental infrastructure for drinking water or waste treatment, local tax-exempt buyer markets cannot absorb all the debt is needed to pay the costs.

This brings us to the problem I would like bring to your attention today. In the code, governmental issuers who sell less than $10,000,000 in a calendar year have available to them a market for their bonds which is not available to anyone else. Banks.

Banks are interested in this debt because it is so-called bank eligible debt on which they can still deduct their carrying costs. For issuers who sell over $10M none of their debt can be sold as bank eligible debt. What happens in this system to the small community, selling less than $10M in a calendar year, who wants to obtain the benefits it can only get by selling through a Bond Bank pool? They are denied the benefit of bank eligibility solely because the Bond Bank sells more than $10M in a calendar year.

What this means is that the small issuer who can obtain a benefit from selling with the Bond Bank pool is denied the 1/4 of 1% benefit it can get by selling bank eligible debt. It also means that the federal treasury suffers the lost revenue associated with the higher interest rate that this small issuer must pay because its debt cannot be bank eligible when it is in the Bond Bank pool. The local issuer pays more interest than the market says that it must and the federal treasury loses more money.

Attached to my testimony is an amendment to Subparagraph (A) of Section 265 (b) (3) of the Code which corrects this problem. This amendment allows small communities to continue to get the benefit of the lower interest rate of bank eligibility along with the lower interest rate and issuance cost savings available to it only when it sells in a pool such as the Maine Bond Bank. The amendment accomplishes this improvement without any financial benefit to the state issuer. The benefits available in this amendment are available only to the local issuer of the debt, on

its local debt interest rate. I believe their are legitimate benefits which should be made available to the state level issuer as part of this change, such as allowing for payment of costs of issuance when the state is selling on behalf of the local unit, but they are not included in the amendment so as not to cloud the issue of the importance of providing the bank eligibility benefit to all local issuers of $10M or less, regardless of the format in which their sale of debt takes place.

More and more states are coming to recognize the fact that they can and must play an even greater role in assisting local governments in raising the money they need for capital projects. Particularly in rural states with smaller communities this state role of credit facilitator and enhancer is important. In order for these state level assistance programs to be most effective they most work for all local governments. By forcing communities to attempt to decide between whether they can sell locally bank eligible tax exempt debt as opposed to selling in the national credit markets with a pool like the Maine Bond Bank we fracture the unity that is needed to be able to give all local governments the lowest total cost debt financing mechanisms we can.

Federal and state governments are demanding many things of local governments today. The need for capital in infrastructure financing alone is staggering. In Maine, we will have to raise well over a billion dollars between now and the end of this century to pay for Drinking and Waste Water facilities. I believe that the adoption of this amendment to the Code will provide a small, but important step in assisting local government, particularly our smaller and more rural communities, in raising the most affordable capital available so that they can undertake the work that must be done.

Thank you for the opportunity to speak with you today. I would be glad to attempt to answer any questions the Committee members may have.

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BANK ELIGIBLE BONDS IN POOLED SALES

Proposed Technical Correction to Section 265(b) Internal Revenue Code of 1986.

Attached is proposed technical correction to Section 265 of the Internal Revenue Code of 1986, drafted at the Bank's request by its bond counsel, Hawkins, Delafield and Wood. Given the composite issue language in the report of the Committee on Ways and Means to the Miscellaneous Revenue Act of 1988 the proposed language has been carefully drafted with a view to prevent any perceived potential for abuse this proposal might raise with respect to pooled financing.

The proposed technical corrections are intended first, to prevent qualified small issuers from being harmed by their participation in a bond bank financing by application of the composite issue rule. For example, in the instance in which a town issues $1,000,000 in January, sells its note to a bond bank that contemporaneously issued $20,000,000 to purchase a number of local notes, and then issues an additional $5,000,000 in December of the same year, it is proposed that the $5,000,000 should be bank deductible and the situation should not be viewed as if the town had previously issued $20,000,000 through application of the composite rule. This is the way in which the current law operates.

Second, the proposed technical corrections permit qualified small issuers to benefit from the interest rate reduction they would have been eligible to receive had they not participated in a pooled financing through a "pass-up" of their bank deductible status to the pooled issuer. In the amendment, the publicly offered pooled issue benefits from a lower rate only on the portion if its sale used to purchase bank deductible status obligations which interest rate saving it will pass through to the qualified small issuers. To prevent any perceived potential abuses, the proposed technical correction requires a matching of dollar amounts and maturities, and an actual tracing of proceeds.

BANK DEDUCTIBILITY

Subparagraph (A) of section 265(b)(3) is amended to read as follows:

(A) IN GENERAL - Any qualified tax-exempt obligation acquired after August 7, 1986 or any qualified tax-exempt pooled obligation shall be treated for purposes of paragraph (2) and Section 291(e)(1)(B) as if it were acquired on August 7, 1986.

Subparagraph (F) of Section 265(b)(3) is amended by adding to the end thereof the following new sentence:

For purposes of this subparagraph (F), the term "composite issue" shall not include any qualified tax-exempt obligation merely by a reason of its purchase by a pooled issuer.

Paragraph (3) of Section 265(b) is amended by adding to the end thereof the following new subparagraph:

(G) QUALIFIED TAX EXEMPT POOLED OBLIGATION - For purposes of subparagraph (A), the term "qualified tax exempt pooled obligation" means a tax-exempt obligation issued by a pooled issuer as part of an issue

(I) which is not a private activity bond (as defined in section 141);

(II) the proceeds of which are actually and exclusively used to acquire one or more qualified tax-exempt obligations;

(III) the face amount of which does not exceed the aggregate amount of the acquired qualified tax-exempt obligations; and

(IV) the debt service schedule of which corresponds to that of the acquired qualified tax-exempt obligations.

PREPARED STATEMENT OF REPRESENTATIVE E. CLAY SHAW, JR.

Mr. Chairman, I am delighted to testify before this committee in strong support of S. 649, a bill to repeal the excise tax on boats costing over $100,000. I have introduced companion legislation to S. 649 in the House (H.R. 951). My bill currently enjoys the support of over 100 House members, as well as a substantial number of Ways and Means members, the committee I serve on.

As members of this esteemed committee will recall, this 10 percent "luxury" excise tax on boats costing over $100,000 passed last October, as part of the 1990 Budget Reconciliation Act. This tax was drafted and passed by Congress in haste and in virtual secrecy. There was no research about its impact, and no chance for comment by the public, accountants or tax lawyers who might have pointed out flawed assumptions or other pitfalls of this tax. The marine manufacturers did not testify before Congress, and neither did the American worker. As I am sure members of this committee are aware, tax legislation should be prepared during an extended legislative process that involves public hearings and intense analysis. Since Congress was in a frenzy to "soak the rich" and adjourn last year, no analysis was done, and the result is a destructive tax.

If Congress had bothered to consult with the experts, we would have been told that the marine industry declined 42 percent from 1988-90. Anyone with common sense knows that levying a tax when an industry is already hurting is not wise policy. But Congress was not interested in wise tax policy; Congress was interested in making a political statement ("soak the rich"). Now that the statement has been made, I say let us move on to correct this mistake. Certainly this hearing is a step in the right direction, and I commend you, Mr. Chairman, for holding it.

Our nation's marine industry is an important generator of wealth for our nation. In 1990, $13.7 billion was spent at the retail level alone on boats and related expenditures. Over 486,000 people are employed in the U.S. boating industry (twice as many as our domestic steel industry). Many of these workers are skilled craftsmen, as boat building is very labor intensive. Hence, when a boat building job disappears or goes overseas, we waste the talents of an American artisan. According to reliable estimates, over 19,000 of these skilled, blue collar workers will lose their jobs primarily because of this 10 percent excise tax.

The boating industry also helps reduce our trade deficit. The industry registered a $249 million trade surplus in 1989, and a $616 million trade surplus in 1990. Import penetration in the U.S. market was under 5% in 1989. The reason our marine industry dominates the global boating market is simply because we produce the highest quality boats. An American manufactured boat is synonymous with quality and reliability. I wish we could say that about some of the other durable items this country produces. Some observers contend that the Japanese and Germans see our slumping domestic marine industry as the perfect opening to increase their market share in this country, just as they did with automobiles, electronics, etc. I view this threat as yet another unforeseen consequence of this onerous tax.

Some skeptics of this repeal legislation contend that the reason our marine industry is in a depression is solely because of the recession, and that the excise tax has had little or no effect on the industry. This reasoning is patently ridiculous. First, and perhaps most importantly, we can look to other nations which instituted a similar tax, and learn from the folly of their ways. For example, lawmakers in Britain and Italy in the 19705 found that boat sales decreased by double the percentage amount of the excise taxes they levied, and tax revenues decreased when they implemented an excise tax on boats. Hence, from the experience in Britain and Italy we have reason to expect a 20 percent additional decline based on the 10 percent tax in this country. Subsequently, Britain repealed its tax and Italy reduced its tax. Unfortunately for those countries, they devastated their marine industries in the process.

Secondly, people can easily avoid this tax. They can just not buy a boat. Instead they can spend the money on an European vacation or jacuzzi, or some other big-ticket luxury item which Congress does not presently tax. Another easy way to avoid the tax is by buying a used boat. They can also buy their new boats overseas and just "visit" the United States. This is already happening in the Bahamas. In response to Congress passing the 10 percent tax, the Bahamas in turn *reduced* their boat taxes to less than 1% of a vessel's value. This move stands to hurt my home state of Florida the most, simply because of the popularity of boating in my state and Florida's proximity to the Bahamas. As the Bahamas are only 50 miles off the coast of Fort Lauderdale, it now makes sense to buy and slip a boat in the Bahamas and use it in the States. This move will lure American boaters, draw boats sales and

service, as well as tourism to the Bahamas, and in turn, create jobs for the Bahamas at our expense.

[Interestingly, this is not the first time Congress has levied a 10 percent excise tax on boats, and hopefully, not the last time it will repeal such a tax. Congress levied a 10 percent tax on boats to raise revenue for World War I, and then repealed the tax in 1924. In the report language of the repeal bill (H.R. 6715, Report No. 179, 68th Congress), Congress gave its reason for repealing the tax:

> The tax upon the sale of yachts is a great burden to yacht builders of this country, since it forces persons to purchase yachts outside the United States from foreign manufacturers in order to avoid the tax.

This scenario is remarkably similar to what is happening today with the Bahamas.]

Finally, boats are a very elastic product. Any increase in price markedly impacts sales—and the price of boats and boating went up dramatically last year, thanks to Congress. I can understand the boaters' feeling they were singled out by the Congress last year. Congress not only levied this 10 percent excise tax on boats, but also a "user fee" for all registered boats over 17 feet, new fuel taxes, and a $35 FCC radio fee. Is it any wonder customers are staying away from buying new boats in order to avoid paying any more taxes to the federal government?

Of course, the stated reason for this tax was to help reduce our huge federal deficit. The boat tax was projected to raise $148 million over a 5-year period, according to the Joint Committee on Taxation. In fact, this fiscal year, the tax is expected to raise a paltry $3 million. The tax is then projected to raise $7 million in FY92, $42 million in FY93, $46 million in FY94, and $50 million in FY9S. Although I admire the often useful work of the Joint Committee on Taxation, their projections are at best an informed guess, and at worst, a shot in the dark. From the anecdotal evidence I have seen, no one is selling boats, and therefore, no one is paying the tax. You cannot tax something that does not exist. In the long run, I believe this tax will be a revenue loser.

I contend that this tax will cost the government more money than it ever hopes to collect because of the hidden cost of the tax. Specifically, I refer to the cost of enforcement by the IRS, the cost of compliance by retailers (higher costs in time, extra paperwork, and perhaps lost business), revenue losses from reduced tariff collections, increased unemployment benefits, and the general "ripple effect" when an industry lays off its workers. I believe that when you add up all these factors, this tax will be a revenue loser.

I am not alone in my assessment. According to the *New York Times* (1/22/91), some tax experts and business leaders say the overall luxury tax may cost retailers and the IRS more to collect than the revenues it brings in. Peter Scott, former general counsel to the IRS, has stated, "The revenue gains from the luxury tax are illusory; businesses and the IRS will spend two or three times more to comply with and collect it than the small amount of revenue it raises." One more point: Before this tax was passed, the National Marine Manufacturers Association estimated that 8,000 American workers would lose their jobs because of it (that figure has since been revised upward to 19,000). Those 8,000 marine workers were expected to pay $30 million in federal income tax this year—ten times what the federal government expected to raise from this tax. Of course, the federal government can now expect to lose even more federal income tax revenue since 19,000, instead of 8,000 marine workers, are projected to lose their jobs.

The evidence is overwhelming—the boat tax is an unmitigated failure and a plague the Congress has visited upon an important American-dominated industry. Instead of raising revenue, it loses it. Instead of making rich people pay more taxes, it throws people out 'of work. It invites international predatory competitors to prey on our weakened market. It destroys small businesses.

Mr. Chairman, I urge this committee to favorably report out S. 649. Congress made a mistake in passing this tax. Let us not let class warfare disguised as deficit reduction dictate the destruction of jobs, of peoples' futures, and the vitality of the boat building industry in America. This legislation in not about giving a tax break to someone rich who wants to own a yacht; it is about American jobs, pure and simple. Let us treat it as such.

Thank you for your consideration.

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Prepared Statement of Representative Olympia J. Snowe

S. 649, Legislation Repealing the 10% Tax on Certain Boats

Senator Boren and Senator Roth, first let me preface my remarks by thanking you for the opportunity to testify in favor of legislation repealing the new, 10 percent federal excise tax on boats that cost more than $100,000. I appreciate having the opportunity to tell you why the passage and enactment of this measure is so very important to the people I represent in Maine.

When this tax was originally drafted, the intent was commendable: namely, to ensure that the highest income taxpayers continue to pay their fair share in taxes.

However, as commendable as that goal might have been, in actuality the 10% tax on boats is having an entirely different impact—it's putting highly-skilled, blue-collar workers at Maine's boat building companies out of their jobs.

According to the Maine Marine Trade Association, (MMTA) there are twenty-four companies that build recreational boats selling for more than $100,000 in Maine. These businesses directly employ roughly 500 Mainers.

The MMTA estimates that half of these 500 jobs have either already been lost, or are seriously at risk, due to the recession in the boatbuilding industry, exacerbated by the new 10% federal tax. What this tax has done is send an already slumping industry into a freefall.

This is happening because few, if any, orders for new boats covered by the tax are being placed these days. Indeed, the June 1991 edition of *Trade Only*, an marine industry publication, reports that sales of boats costing more than $100,000 have fallen 86% from last year's level!

This torpedoing of new boat sales makes it unlikely that the revenue projected under this tax will be realized. Compounding this will be the loss of income taxes from laid-off workers and additional expenditures in federal programs, such as unemployment compensation.

Let me briefly describe to the Subcommittee the effect this tax is having on the boat building industry in Maine.

Earlier this year, one well-known boat building company in Maine let go 10 percent of its workforce and instituted a 10 percent pay cut for the firm's remaining 135 workers.

This same firm has had only one new order for the construction of a boat this year. And they were able to get this order only after the company itself agreed to pay the 10% tax on the boat's cost!

Then there's another family-owned company, one that's been in the boat building industry in East Boothbay Harbor for more than 160 years. Their business has declined so much that they have laid-off 11 employees, taking their employment level from 20 people down to nine.

A custom boat building company is Southwest Harbor has suffered such a decline in orders that, while it used to employ 40 people, it now only has enough business to support 13 employees.

Yet another boat builder has had four orders for new ships put "on hold," because the customers are having second thoughts about buying these boats, due specifically to the new tax. Consequently, this company has laid-off half of its workforce, and may have let the remaining employees go if business does not pick-up soon.

Finally, a boat building company in Trenton, Maine recently filed for Chapter 11 bankruptcy protection from its creditors, and is trying to reorganize itself.

In Maine, many of these boat building companies are small, family-owned businesses that have been in operation for generations. In coastal towns along the rocky shore, building boats has been a way of life, not a 9-to-5 job.

All of these remaining jobs are being threatened by the new 10% federal tax on boats. That's why so important for this Subcommittee, and the 102nd Congress to swiftly repeal this devastating tax.

That's also why I am a cosponsor of H.R. 951, repeal legislation introduced in the House by Congressman Clay Shaw.

Mr. Chairman, with this tax Congress took a shot at the wealthy, but hit low- and middle-income workers. As one boat builder said, "These rich guys don't need to own the boats as bad as we need to build them." The recession is tough enough in Maine without this kind of piling on, so I urge you to "sink" the boat tax.

Prepared Statement of Representative Barbara F. Vucanovich

Mr. Chairman, I appreciate the opportunity to appear before you today in support of S. 267 which would prohibit a State from imposing an income tax on the pension

or retirement income of individuals who are not residents or domiciliaries of that State.

On January 3, 1991, in response to a growing anti-tax movement in my State of Nevada and in many other States, I introduced H.R. 431 in the house. Both S. 267 and H.R. 431 would put an absolute ban on the unfair practice of taxing non-residents' pension income.

Many retirees who have moved to other States suddenly find their pensions taxed by the State of their former residence. I feel that it is unfair that these people are being taxed by States where they receive no benefits and cannot vote. Retirees who had their incomes taxed the first time around while employed ought not be taxed a second time on their pensions by a State where they no longer live. Retirees on fixed incomes should live comfortably, without worries of being unfairly taxed by other States.

As you know, my State of Nevada has no income tax, however, this issue does not only concern retirees living in states with no income taxes, it is an issue of concern to retirees all over the country. Many States have source tax laws, although many don't go after the pensions of ex-residents. What is of concern to many folks is that these States may activate the source tax laws at any time they so desire. Just ask retirees who are ex-residents of California how these source tax laws affect them. California is the most aggressive of the taxing states. It has hired collection agencies to collect unpaid nonresident taxes on pensions. These agencies harass and threaten senior citizens. California includes in the tax assessment a 55 percent penalty and daily interest. In many of these cases California was delinquent in notifying the taxpayers of the tax thus creating huge interest penalties and an overwhelming tax burden. In addition, California and some of the other States, not satisfied with just taxing the pension, base the tax rate on the retiree's total income. by this action, they manage to levy a tax on the retiree's out-of-state income, too, whether from investments or another job. simply stated, this is "taxation without representation."

Mr. Chairman, the Boston Tea Party and the Revolution occurred because of unreasonable taxation without representation. Congress must resolve this situation as soon as possible; our seniors and retirees deserve no less.

In addition to H.R. 431, which has 115 cosponsors, I have introduced H.R. 1655 which has been referred to the House Ways and Means Committee. This bill would amend the tax reform act of 1986 to: (1) provide taxpayers with an advance notice of the tax, (2) use a taxing formula that does not include income from other States, and (3) provide taxpayers an opportunity to prepay the tax before they actually leave the state. H.R. 1655 has 33 cosponsors.

S. 267, H.R. 431 and H.R. 1655 do nothing more than provide simple fairness and decency to our senior citizens and to all American taxpayers who may live in one or more States during their lifetime.

On the State level, my State of Nevada has passed legislation that would "exempt property in Nevada from execution for failure to pay income tax to other States on benefits received from pension or retirement funds." The statute does not invalidate another State's source tax; it merely prevents collection by placing a lien on the individual's property located in Nevada. The State of New Jersey has gone so far as to repeal its tax on nonresidents' retirement income.

Finally, Mr. Cchairman, I would like to welcome Mr. Bill Hoffman, a constituent of mine from Carson City, Nevada. Bill, along with his wife Joanne, founded the "resist" organization, retirees to eliminate State income source tax, and have worked tirelessly for this just cause. Bill will be happy to answer your specific technical questions. along with "RESIST", the coalition consists of the Air Force Association and thirty one military organizations and the National Association of Retired Federal Employees.

Thank you, Mr. Chariman.

Prepared Statement of Mary Ellen Withrow

Good morning, Chairman Boren, members of the subcommittee. I am Mary Ellen Withrow, state Treasurer of Ohio and senior vice president of the National Association of State Treasurers (NAST). I am pleased to be joined today by my colleagues and friends from California, Maine, Oregon and Texas. I thank the subcommittee for the opportunity to testify today on behalf of NAST in support of S. 913, the Tax-Exempt Bond Simplification Act of 1991.

It's true that we've heard repeatedly about the decay of our country's bridges and sewer systems, highways and water treatment facilities. In the 1980s, this issue took

on a sense of urgency and the public responded with great interest and resolve to rid our country of this problem.

In fact, in July 1986 one of the funniest photos to run in our nation's newspapers and papers across the world was no joke at all. One morning during rush hour in downtown Columbus, Ohio, a local lawyer and his Mercedes Benz were swallowed by a huge sinkhole which developed when a large portion of the city's sewer system catastrophically collapsed. Luckily, the car's driver emerged unscathed, but a celebrity nonetheless.

This event, however, could have been disastrous. Hundreds of cars and pedestrians travel that area each day, for it sits merely a half a block from the Ohio Statehouse. *(See Attachments 1 and 2).*

These stories go on, with similar occurrences in each state.

That's why I'm here today to talk with you about the importance of tax-exempt financing and the need for federal regulation that really makes sense, the need for federal regulation that doesn't tie the hands of state and local governments and our ability to implement programs.

In the 1980s, the voters of Ohio responded to such an emergency and overwhelmingly approved an historic ballot issue in November 1987. Called State Issue 2, the referendum created the Ohio Infrastructure Bond Program, the nation's first infrastructure program created by an amendment to the Ohio Constitution.

The Ohio Infrastructure Program strives to construct a state-local partnership to maintain and restore the essential services of community life.

The Ohio program is important in three respects. First, it represents a significant investment by a state in an area which has seen dwindling revenues in the last two decades. Issue 2 demonstrates that Ohio and its citizens put infrastructure at the forefront of their public policy concerns.

Secondly, the program declares that states must claim a share in what was previously considered a local interest. In this respect, the Ohio plan recognizes the mutual interest in infrastructure that exists between all levels of government.

Last, the Ohio Program creates a system of decision-making that places much of the responsibility for directing state spending into the hands of local officials. This ensures that money goes where it's needed in an efficient and effective manner. *(See Attachment 3.)*

HOW THE PROGRAM WORKS

Specifically, the Ohio Infrastructure Program allows the state to use general revenue as support for general obligation infrastructure bonds. These bonds are issued solely by the Treasurer of State for a maximum amount of $120 million per year. Total infrastructure funding available during the life of the program is $1.2 billion.

To effectively distribute this money to Ohio's communities, the state is divided into 19 funding districts. There is a maximum cap on the amount of infrastructure money any one district can receive, based on population. Roughly, this amounts to $10 per person per district over the life of the program.

For example, Cuyahoga County's district—basically, the Greater Cleveland area—can receive up to $15 million per year through the program. Smaller districts, made up of several rural counties, might receive less than $4 million a year.

Of the approximately $120 million available to the districts each year, $12 million is set aside for small governments with populations of less than 5,000 people, and up to $25 million is retained as emergency funds.

Further, the Ohio Infrastructure Program includes a loan portion of the plan, set up to be a revolving loan program which will continue well past the 10-year period established for bond issuances.

The emphasis in the Ohio program is on replacing and repairing existing infrastructure systems. In the Cleveland area alone, funding for recommended infrastructure projects totals nearly $54 million for a three-year period. Eligible projects for the Ohio program include the improvements of roads, bridges, drinking water systems, waste water facilities and solid waste handling facilities.

These projects are designed to receive up to 90 percent state funding. Projects creating new infrastructure systems may receive up to 50 percent state funding.

The funding process generally operates like this: local officials interested in receiving infrastructure funding must work through their district committee. Each district committee is made up of individuals appointed by their local governments and acts as the local arm of the infrastructure program. Only by committee approval may a subdivision receive a grant or a loan through the program.

But before they file an application with their committee, a subdivision must conduct a thorough study of its infrastructure needs and responsibilities, called a Capital Improvement Report (CIR).

The report must include:

—an inventory of existing infrastructure;
—an identification of capital improvement needs; and
—a prioritized listing of the subdivision's upcoming infrastructure financing projects.

The district committee essentially acts as a filtering device for these capital improvement reports. The committee evaluates the CIRs based on prescribed criteria and information pertinent to the district. Criteria are designed to show the importance of a project to a district, as well as the extent of the assistance required to move the project forward.

The committee must also consider the best use of the limited funds available to their districts. For that reason, cost-effective projects are most likely to receive the blessing of the committee.

Capital improvement reports are ranked based on this criteria, with those ranking highest considered for funding first.

If the proposed projects clear the district committees, they are sent to the director of the Ohio Public Works Commission (OPWC). The OPWC is the group statutorily charged with the implementation of the Issue 2 Program. If a project application is found to be in harmony with the program's other requirements, a funding agreement is produced and sent to the subdivision.

It is important to note that no subdivision receives grant money up front. The OPWC makes disbursements of program funds to local governments based on the amount of work completed. Thus, potential abuses are eliminated.

To date, nearly 850 infrastructure projects have been funded through the Issue 2 program. The projects will provide the State of Ohio with more than $350 million in infrastructure facilities. Two bond issues, totaling $240 million, were brought to market by the Treasury in 1988 and 1989. We anticipate another sale this year as the OPWC distributes the remaining infrastructure funds. We did not issue bonds in 1990 because funds remained from the previous two issues.

So far, most of the infrastructure funds have been awarded as grants. But by year 3 of the program, at least 10 percent of the district allocations must be used as low interest loans or loan assistance. By year 5 of the program, at least 30 percent of all Issue 2 monies will be distributed as loans.

Each loan recommended by a district committee is of great future value to the district involved. The value of a loan's repayment is directly recycled back to the district making the loan. This "recycling" or "roll-over" occurs as often as the value of loan repayment revenue is sufficient to support a sizable revenue bond. District committees that are aggressive in their loan-making activities, both in loan volume and high-end interest rates, benefit from having more funds returned to them for additional loan-making in future years.

The Ohio Infrastructure Program is the only program structured to get both state and local governments directly and actively involved in infrastructure financing. This partnership ensures that infrastructure funds do the job they're meant to do.

Modified for the needs of Ohio's citizens, the Ohio Infrastructure program is an example of a successful, functioning bond bank. Though many state bond banks offer primarily infrastructure loans, Ohio has found that a strategic mix of grants and loans makes the program both practical and enduring.

In 1987 after Ohio voters approved such a progressive initiative, the Ohio Infrastructure Bond Program was designed and implemented to follow the guidelines established by the federal government in 1986. The Ohio plan is an excellent example of an effective and prudent effort to finance state capital needs.

THE OBLIGATION OF A PUBLIC OFFICIAL

Like members of the United States Senate and other elected officials, when I first took my oath of office, now eight years ago, I promised to fulfill my duties as an elected official to the *best* of my abilities, always working for the betterment of the people of our state.

But it very much disturbs me today to know some other elected officials, charged with the care of public funds, are forsaking their public duties to circumvent the burden of the 1986 Tax Reform Act.

In the Ohio Treasury, it is our objective and our duty to make the most out of every tax dollar and since I took office in 1983, my office has earned more than $1.6 billion in investment earnings—all non-tax dollars for the people of Ohio. Last year alone, we earned more than $300 million.

But some other public funds managers see the picture a different way. Why should they earn as much as they can on the investment of their bond proceeds,

when the earnings must go, not to their community or needed projects, but to the federal government? Unfortunately, some public officials now resort to what is called "yield burning." The potential of public investments is not maximized, thus less is earned and fewer dollars are rebated to the federal government.

This leads me to another point. More than 200 years ago, the newly-established colonies of New England rebelled against the taxing burdens of Mother England. The result was the infamous Boston Tea Party. Like the early revolutionists, public officials today are rebelling against the tiresome calculations and the overwhelming burden placed on them by the 1986 tax laws and arbitrage rebate.

It remains in the enduring Constitution of the United States that one level of government should not tax another level of government. Yet arbitrage rebate amounts to nothing more than the federal government taking from the people what was *earned* at a state or local level.

But still, until Congress amends or repeals any law, it is still the duty of each of us to follow the statutes of our country.

In the Ohio Treasury, we have assumed the burden of monitoring tax laws and modifying our investment pool to assist local governments in meeting their arbitrage obligations.

STAR Ohio, the State Treasury Asset Reserve, is a public funds investment pool managed by the Ohio Treasury. Started in 1986, the program now has assets of more than $2.9 billion and more than 1,700 accounts.

Its users are our state's cities, counties, townships, villages, fire districts, and water treatment facilities. Schools, however, are one of the largest participants in STAR Ohio. Proceeds from both the 1988 and 1989 infrastructure bond issues and other funds from local bond issues are also invested in STAR Ohio.

STAR Ohio now offers an even greater service to such investors. In recent years, we have developed a program to calculate the arbitrage rebate of bond issue earnings—at no cost to shareholders. I'm sure you will agree the calculation method and tracking of arbitrage can be very tiresome and confusing. For those who do not invest in STAR Ohio, I'm sure this is a huge burden on their investment managers. For them, bond counsel must be hired or software must be purchased in order to track and meet arbitrage requirements. For a township or small fire district, either alternative can be very costly.

For those who do invest in STAR Ohio, however, I hope our service has made their job of complying with federal regulations much easier.

SUPPORT FOR THE TAX-EXEMPT BOND SIMPLIFICATION TAX ACT OF 1991

It is true the 1986 Tax Reform Act was passed to prevent abuses in the funding systems set up throughout the country. But some of the provisions of that legislation are overwhelming. Still, if you must have such strict laws to prevent abuses, then let there be some incentive to those of us who are doing it right—those of us who are following the laws you established.

That is why I am very much in favor of the passage of the Tax-Exempt Bond Simplification Act of 1991, sponsored by Senators Max Baucus (D-Mont.) and Christopher Dodd (D-Conn.)

You took the first step in assisting government bond issuers when some amendments were made to the 1986 tax reform bill. Your 1989 amendment offered Ohio an alternative to rebate. While we still anticipate paying several million dollars in rebate from our 1988 Infrastructure Bond issuance, we chose in 1989 to take advantage of the change in the laws and were able to meet the spend-down requirements. Therefore, we do not expect to make payment to the federal government on rebate or face a penalty.

Today, most bond issuers are at the local level—small cities and villages which are trying to meet the needs of their communities. Perhaps their water treatment or waste treatment facilities are old and outdated. Through bond issues of only a few million dollars, they are taking the initiative to improve their community.

Yet, it is these small communities which truly need the investment earnings from their public funds. At all levels, each dollar earned is needed, but at a very local level of government, each dollar and cent is often needed to fund and complete projects to improve the lives of the residents.

I am very much in favor of the provision in this legislation which increases the small issuer exception to arbitrage rebate from $5 million to $25 million. There are few abuses at the level of smaller bond issuers. Help them endure the hardships placed on them by dwindling tax bases and fewer tax dollars from the state and federal governments. It is the people in our townships, villages and smaller cities who would truly benefit from such an amendment.

Further, I also support the provision of S. 913 which allows the bond issuer to pay only 90 percent of the arbitrage earned as a rebate. Allowing issuers to keep 10 percent of what they earn in arbitrage is indeed an incentive to maximize their earning potential and stop the abhorrent practice of "yield burning."

Quite honestly, without such an amendment, some bond issuers opt for a short-cut which short-changes the federal government. I'm sure the federal government hasn't earned as much from arbitrage rebate as anticipated. With such an incentive, the federal government will receive more dollars and state and local governments will benefit by retaining a portion of their arbitrage earnings.

PROPOSED MODIFICATIONS TO S. 913

While I, along with public funds managers at all levels, appreciate the proposal of paying only 90 percent of the arbitrage earned, we would appreciate an even larger portion of arbitrage earnings.

This is still money *earned* by state and local governments. And in the end, I'm sure legislation which will be passed will ensure the federal government will receive the majority of arbitrage earnings. But grant us the opportunity to benefit also from *our* efforts. An amendment allowing us to keep 20 percent or even 15 percent of what we earn would do much for the good will of government working together at all levels.

Further, for those of us who comply fully with federal arbitrage rebate laws, offer us a federal credit back to our state in highway dollars or other federal funds to complete much-needed projects. Help us ensure that our earnings will go on to assist the people of our state.

CONCLUSION

Through my efforts as Ohio Treasurer, I have worked with many other public officials at the federal, state and local level. I am a member of the Anthony Commission on Public Finance and past president of the National Association of State Auditors, Comptrollers and Treasurers. I support Rep. Beryl Anthony's bill, H.R. 710, and the Baucus-odd companion bill, S. 913.

I have spent much time talking with my colleagues in other states and I assure you we are all concerned about the same things—primarily the burden on state and local governments which are expected to deliver more services with less money—all with fewer federal tax dollars and oppressive federal tax laws.

I understand the need for such legislation. Some take their duties lightly, others do not make themselves accountable to their people.

But in Ohio and many other states and localities, we are doing it right. We follow the tax laws and other laws of our country. Please work with us and give all public funds managers an incentive to work hard to maximize the earning potential of arbitrage investments.

And that's important, because in the years ahead, the only thing infrastructure advocates can count on is less money for public works projects.

It's up to us to create and carry out the innovative capital investment programs that will ensure a sound future for our communities.

Attachments.

Sewer line caved in to old age

By Alan Johnson and
Ray Belew
Dispatch Staff Reporters

The collapse of a 114-year old sewer that left a big crater in W. Broad St. yesterday could be repeated, especially Downtown, if decaying sewer lines aren't replaced, a development official said.

"It's not a joking matter," said Joe Neidhardt of the Development Committee for Greater Columbus. Neidhardt is coordinating a $150,000 countywide study of roads, sewers, bridges and waterlines for the development committee.

"I've given talks about the danger of sewer collapses Downtown," Neidhardt said. "When I looked down into that hole, I thought we were very fortunate that it wasn't worse."

The 42-inch brick combination sanitary and storm sewer line that collapsed about 8:15 a.m. yesterday in front of the LeVeque Tower was built in 1872. Another 18-inch brick line beside it was built in 1884. The second line also carries Downtown sewage and storm water.

WHEN THE sewer failed, it sucked in about 12,000 cubic feet of sand and gravel, hollowing out the earth supporting a 20-by-30 foot section of W. Broad St., said Lois E. Ferell, development planner for the city's Division of Sewerage and Drainage. The result was a 20-foot-deep hole that Michael M. Schmidt's car fell into. He was not injured.

City officials have estimated the repairs may not be completed until Monday. W. Broad St. is closed between Front and High.

Officials said they would have to wait until today to begin repairing the sewer because Columbus & Southern Ohio Electric Co. workers had to reroute power lines that cut through the collapsed section of street. The rerouting was completed last night, and the electrical workers expected to be finished with other work in the hole by early this morning.

"We will not enter the area until it's de-energized," said Michael Long, head of the city's Public Utilities and Aviation Department. "It's too dangerous."

WHEN THE collapse occurred, debris slid past two Ohio Bell trunk lines that control telephones on part of the West Side and six 13,000-volt power lines that feed Downtown buildings, spokesmen for the utilities said. The lines are about 10 feet below the pavement.

None of the cables was damaged, but utility workers were kept out of the pit until 12:30 p.m. because of the possibility of a short circuit in the power lines.

The hole disrupted traffic and slowed COTA buses. Westbound buses were rerouted, and some bus stops were moved, a COTA spokesman said.

COTA riders who head east can still catch their buses at Broad and High Sts., COTA spokesman Paul Quinn said. Those going west should go to either 3rd and Broad or Front and Broad.

THE BIG hole drew spectators all day.

Long called the collapse an "isolated incident. There is no cause for alarm."

But he said city crews will run special television cameras through the sewers to check for further decay or blockages.

"Columbus does have a good program of sewer replacement and rehabilitation," he said. "The problem comes as our sewers come of age."

Neidhardt is much less optimistic.

"We know there are brick sewers underneath the streets," Neidhardt said. "But they were built to fail."

Warren J. Cremean, former Columbus service director, said the problem is not brick sewers but the volume of water passing through the combined sewers.

"What happened is that we have a greatly increased volume of storm water because of the number of Downtown parking lots, and the volume exceeds the capacity of the old system."

HEAVY RAINS early yesterday didn't create the problem, which probably involved erosion over a long period of time, Cremean said.

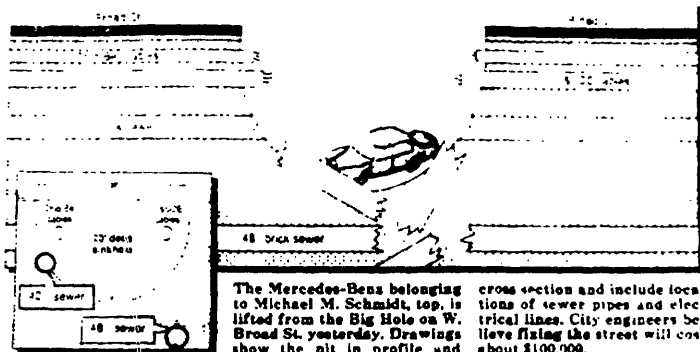
Robert Roush, sewer maintenance manager for the city, said cave-ins are not uncommon around older sewer lines, but he said this is the largest he has seen in his nine years with the city. He said Columbus has many similar sewer lines in the older parts of town.

City workers will check for sewer line damage by crawling through the Broad St. sewer between Civic Center Dr. and 5th St. next week, Ferell said.

The city has 206 miles of combined storm and sanitary sewers, less than a 10th of the total, she said. "Only a small fraction of the combined sewers are brick, and we've been separating the sewers as we can. Most of those remaining are Downtown."

The city just paid Columbus Engineering Consultants $28,700 for a sewer line study that was received May 20. The next step is to award contracts for engineering design work for repair of these downtown sewers from the Innerbelt on the east to the Scioto River on the west.

Dispatch photo by [illegible]



The Mercedes-Benz belonging to Michael M. Schmidt, top, is lifted from the Big Hole on W. Broad St. yesterday. Drawings show the pit in profile and cross section and include locations of sewer pipes and electrical lines. City engineers believe fixing the street will cost about $100,000.

Hole traps spectators, too

Congratulations, Columbus. We have taken another big step in our quest for national attention

We are known throughout the nation as the city with a Mercedes-Benz in the middle of the hole in the middle of the town

The Big Hole on Broad St., just west of High St., has become a local tourist attraction since it made its sudden appearance Wednesday morning when a sewer collapsed The national news coverage it received may make it a regional attraction because city officials say it may be around for another week.

SONGS ARE being composed. T-shirts can't be far behind.

But those hoping to see the famous hole are in for some disappointment. The Mercedes is gone already. It was lifted out by a crane yesterday. Michael M. Schmidt, the lawyer who drove the car into the 20-foot-deep hole Wednesday, was rescued uninjured.

But even without the Mercedes, the hole is drawing a steady stream of people. Some picnicked yesterday on the steps of the Wyandotte Building and the Huntington Plaza, which overlook the crater.

"I think it is something," said Jason Kean, 46. "I've lived here all my life and never dreamed that I would see something like this in Columbus."

Terri Armstrong, 26, said her aunt in Long Beach, Calif., called Columbus when she heard the news of the crater

"She heard about it on CNN (Cable News Network)," Armstrong said. "She used to live here, and she just wanted to know if it was true or not."

Some people have tried to hang a name on the crater "Bucky's Underground Garage," "Mel Dodge's Sunken Gardens" and "Columbus' Answer to the Grand Canyon" are some that Columbus Police Officer Jim Pennington has heard.

"IT IS SOMETHING that people have been able to have some fun with," Pennington said.

The hole also appears to be the answer to Downtown's moribund night life. At 10:30 p.m. Wednesday, more than 100 people were gawking at the gap.

"It was hysterical," one observer said. "One couple had their dog, a midsized terrier, and lifted it up so it could see the action, too"

Several street vendors moved their carts closer to the crater yesterday to take advantage of the crowds it drew

"I did real well during lunch time," said Denzel Lee McNash, who peddles ice cream bars

Sue Newton, 31, came Downtown to see the giant pothole at the insistence of her 4-year-old son, Armond

"He wanted to see it," said Newton, patting her son on the head "I'm just glad I wasn't on Broad St when it happened."

But it's hard to impress some people. Truck driver Pat Manues, 42, said such things happen all the time in his home state of Iowa.

"In Ft. Dodge, Iowa, there is a lot of underground mining, so we see our share of sinkholes It's just a hole in the ground."

The 20-by-30-foot crater is going to put a good-sized hole in the city's coffers. It will cost at least $100,000 and will require at least a week to repair two sewer lines and fill the crater, Jerry Francis, administrator of the Columbus Division of Sewerage and Drainage, said yesterday

THE CITY HAS HIRED a heavy-equipment contractor to help with the project. There also will be overtime costs for police officers who are directing traffic Whether the tourist dollars that flow in can offset the expenses remains to be seen

Workers are still removing debris from the bottom of the pit. When that chore is finished, city crews will repair a 42-inch brick sanitary and storm sewer built in 1872 and a similar 48-inch line that dates to 1884.

Francis speculated that the lower, 48-inch sewer may have developed a break, allowing dirt to fall into it and be swept away to the Scioto River. The upper sewer apparently gave way when the earth supporting it was gone. That triggered the street cave-in.

The city is looking at various ways of shoring up similar Downtown sewers, Francis said. One way is to install steel plate linings to strengthen the old brick structures.

Until the sewers and street are repaired, police officers will be posted at 21 Downtown intersections from 7 a.m. to 7 p.m. on weekdays

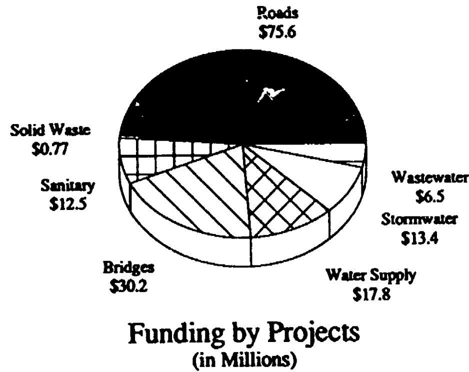
W. BROAD ST. will remain closed between 3rd and Front Sts. Police plans for rerouting traffic are:

- Eastbound traffic on Broad St. from the West Side will detour south on Civic Center Dr to Main St., east on Main St. to 4th St and north on 4th St to Broad St
- Westbound traffic on Broad St. from the East Side will detour south on 3rd St. to Town St., west on Town St to Front St. and north on Front St. to Broad St

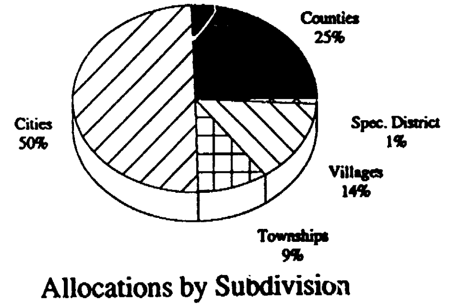
Attachment 2. The Columbus Dispatch, July 11, 1986

Attachment 3.

Ohio's Infrastructure Program
1990



Funding by Projects
(in Millions)



Allocations by Subdivision

PREPARED STATEMENT OF DENNIS ZIMMERMAN

THE DETERMINANTS OF BOAT SALES

Effective 1991, a 10 percent tax was imposed on the portion of the purchase price of a boat in excess of $100,000. The tax does not apply to purchases for business use, such as commercial fishing or transportation, provided the purpose is not entertainment or recreation. The purpose here is to use the last twenty years' experience with how boat sales responded to price changes as a guide to assessing the impact of the luxury excise tax on boat sales.

The demand for luxury boats is expected to be determined by real income (both individual and business), the relative price of boats, financing costs, consumer confidence, real household wealth, and the real price of gasoline.

The boat industry generously provided measures of boat sales, both units and dollars. The industry reports that two categories of boats contain the units subject to the luxury tax, "inboard cruisers" and "auxiliary powered sailboats over 30 feet." Since the distribution of boats by price within these two categories is not available, the analysis presented here measures output as all boat sales within these two classes of boats. The average nominal price of cruisers has exceeded $100,000 every year since 1980 (except for 1983), and was $184,402 in 1990. The average nominal price of the sailboats did not exceed $100,000 until 1990, when it was $108,399. Thus, the great majority of cruisers (which constituted 82 percent of units sold in these two classes in 1990), but a much smaller share of sailboats, potentially are subject to the tax.

Industry data on units sold and total revenue are used to calculate the average sale price, which is divided by the consumer price index to create a relative price of boats. A relative price measure is necessary because demand is expected to respond to a change in the price of boats only if the boat price changes more or less than the price of other goods and services. [1]

The most important of the factors that affect demand is income. Boats are purchased by both individuals and businesses. Individuals' demand is probably sensitive to expectations of permanent or lifetime income. In the absence of such an income measure, income is represented by real disposable personal income lagged one year. In other words, this year's boat sales to individuals are influenced by the income of individuals in the preceding year, a proxy for permanent income. Business income is represented by real corporate profits after tax (adjusted), and business demand is expected to be sensitive to current year profits.

Since boats are durable goods, financing costs may also influence demand. The real corporate bond rate was included to represent the cost of financing a boat purchase (a series on auto loan rates that extended over the entire sample period was not available). Using the bond rate makes the interpretation of its

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[1] A second price measure was tried in the regressions, the implicit price deflator for boats from the producer price indexes of the Department of Labor, also deflated by the consumer price index. It gave results inferior to the average sales price data.

influence difficult because the bond rate affects the cost of producing boats to the extent capital is financed with debt. But the bond rate and auto loan rates are closely correlated.

Changes in household net worth can also be expected to influence the purchase of consumer durables such as boats. Real household net worth was obtained from the Federal Reserve's Flow of Funds Balance Sheets. The University of Michigan Survey Research Center's measure of consumer confidence was also included.

The real price of gasoline was included to test for the possibility that demand for boats was adversely affected by sudden shifts in a major operating expense (gasoline and recreational boats are complementary goods). Another variable likely to be important, but for which no data are available, is the stock of boats for sale in the "used boat" market. Boat registration data are incomplete, and would not be a good indicator of this stock unless the share of registered boats for sale is stable over time. Alternatively, a measure of "used boat" prices would be useful. Because the sale of used boats is not subject to the tax, the relative price of new to used boats can be expected to increase (although not by the amount of the tax, since sellers of used boats can be expected to raise used boat prices in order to capture part of the tax price differential). Finally, any omitted variables that have a systematic influence on sales will be captured by the "error term." [2]

Inspection of the sales data indicate that 1990 is an outlier--the sales decrease experienced in 1990 (from 14,300 to 9,100 units) dwarfs any absolute or percentage change in unit sales during the twenty year period. However, the unexpectedly large decrease to 9,100 units in 1990 cannot be attributable to the luxury tax on boats. The tax was not effective until 1991, and any effect in 1990 should have been to accelerate 1991 sales into the last quarter of 1990 in order to avoid the tax. The usual approach to analyzing such a change is to test for a shift in the demand schedule. This was done by including a shift variable.

RESULTS

Table 1 summarizes the regression results (estimated in double log form) for the sum of cruiser and sailboat units sold. The coefficients reported for the variables are elasticities. They are interpreted as the percentage response of boat sales to a 1 percent change in the variable. All of the regressions were subject to serial correlation that biases the estimated coefficients. This was

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[2] Some might expect population to be an important determinant of demand for boats. The influence of population is captured by the form in which the model is estimated. Units sold and the two income variables are measured in levels and therefore grow in response to population growth.

corrected, and the Durbin-Watson statistics reported in the table indicate that serial correlation has been removed.

The first column reports the estimated coefficients for real disposable personal income (Y), real after-tax corporate profits (C), the real interest rate (R), the relative price of boats (P), the shift variable (S), and a constant term (k). [3] The numbers in parentheses report the t-statistic. A t of 2 or greater implies two things: the hypothesis that the variable has no (zero) systematic influence on the units of boats sold is rejected; and there is a small chance, approximately 5 percent, that the hypothesis of zero relationship has been incorrectly rejected. As t declines, the probability that the true relationship is zero (in spite of the nonzero coefficient in the table) increases at a rapid rate.

Table 1. Regression Results for Units of Inboard Cruisers and Auxiliary Powered Sailboats Over 30 Feet

	1	2
	Years 1970-90	Years 1970-89
Constant k	-10.6 (2.13)	-10.6 (2.13)
Real disposable personal income Y	1.81 (2.11)	1.81 (2.12)
Real after-tax corporate profits C	0.41 (1.93)	0.41 (1.93)
Real interest rate R	-0.07 (0.28)	-0.07 (0.28)
Relative price of boats P	-0.25 (0.42)	-0.25 (0.43)
Shift S	-0.40 (2.89)	
Adjusted R^2	0.847	0.797
Durbin-Watson Statistic	2.43	2.41
Standard Error of the Regression	0.119	0.119

[3] No results are presented that include gasoline prices, consumer confidence, or household net worth--all had the wrong sign and were statistically insignificant (suggesting their true effect on sales was zero).

Column 1 indicates that the model explains 85 percent of the variation in boat sales from 1970 to 1990. Both real disposable income and corporate profits have a positive effect on boat sales. A 1 percent increase in Y generates a 1.8 percent increase in sales to individuals; a 1 percent increase in real corporate profits generates a 0.4 percent increase in business sales. The real interest rate has the expected negative sign, but it is very small (-.07) and is not statistically different from zero (t=.28).

The important coefficient for the issue being addressed here is the relative price coefficient. It has the expected negative sign, suggesting an increase in price will reduce quantity demanded. But the elasticity is relatively small, -.25, and most important it is not statistically different from zero (t=.43). This means that use of the -.25 elasticity estimate carries a very high probability that we are overestimating the price effect, which is probably zero. In effect, this result suggests that sales of inboard cruisers and auxiliary powered sailboats over 30 feet are not very responsive to price changes. Demand is relatively price inelastic.

This is not entirely surprising, since it is commonly believed that the demand for luxury goods is much more sensitive to income than to price. What springs to mind is the conventional wisdom contained in the old saw about the purchase of very expensive consumer durables: if you need to ask about the price, you can't afford it.

The shift variable, S, is statistically significant and indicates that something happened to cause boat buyers to desire to purchase substantially fewer boats at any given price; in other words, the demand schedule seems to have shifted down in 1990. This interpretation of 1990 events is strengthened by the results presented in column 2 of Table 1. The sample period is shortened by dropping 1990 and eliminating the shift variable. The estimated price and income variables remain virtually the same; the only change is a small reduction in the share of the variation of boat sales explained by the regression to 80 percent. [4]

Of course, statistical proof that a shift occurred is no substitute for an explanation of the economic, psychological, or other forces that caused the shift. Three possible explanations come to mind. First, the Gulf war increased uncertainty and may have made buyers reluctant to purchase boats beginning in the third quarter of 1990. This does not seem that likely. The consumer confidence variable mentioned above dropped considerably in 1990, but still did not prove to be statistically significant in explaining boat sales from 1970 to 1990. Second, perhaps the market for luxury boats is saturated. The portion of the population with the means to buy these boats is relatively small, and

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[4] These two models were also estimated with the real interest rate removed and with the alternative relative price variable, from the producer price indexes, substituted for the average sale price data. The statistical significance of the income and price elasticities were not sensitive to these specification changes. The magnitude of the income elasticities varied by about 0.1.

annual sales grew rapidly from 7,465 units in 1982 to 16,000 units in 1987. Sales declined slightly in 1988 to 15,820 and somewhat more in 1989 to 14,300, even though income and corporate profits continued to grow.

Third, it could be that the change in real disposable personal income for the portion of the population that buys luxury boats (and for whom no income data series exists) suffered income reductions substantially larger than other portions of the population. For example, the Treasury Department found that realized capital gains (an important component of income for those with high adjusted gross incomes) dropped substantially beginning in 1989. With sales falling 1.8 percent for every 1 percent reduction in income, a double digit fall in income of the wealthy would help to explain the 1990, and perhaps 1991, sales decreases. In effect, this explanation suggests the possibility of measurement error in the individual income variable Y.

IMPACT ON BOATS SOLD

What do the estimates in equation 1 of Table 1 suggest about the effect of the luxury tax on boat sales? It is important to place the share of boat sales subject to the luxury tax in the context of total boat industry sales. In 1990, 504,100 boats were sold, of which 9,100 (1.8 percent) were in the two categories identified as containing luxury boats. Total sales were $4.604 billion, of which $1.557 billion (33.8 percent) were in the luxury boat class. These 1.8 and 33.8 percent figures represent upper bounds on the luxury boat share of the boat industry subject to the tax, for two reasons. First, boats in the two categories with sale price less than $100,000 would pay no tax. Second, business purchases are not subject to the tax, unless the boat is used primarily for entertainment or travel. No estimates of below-$100,000 luxury class boats or business purchases are available.

The average nominal sale price in 1990 of these 9,100 luxury class boats was $171,039, which implies an average tax of $7,104, or 4.2 percent of average price. The model estimates presented above suggest that luxury boat sales have not been responsive to price changes from 1970 to 1990. If this zero relationship exists today, the luxury tax probably is not responsible for the sales reductions being experienced currently by the boat industry.

This is, of course, a difficult proposition for the boat industry to accept, particularly when sales are declining and a new excise tax has been imposed. It is, therefore, worthwhile to inquire into the amount of sales reduction that could be expected if the seemingly historical zero price sensitivity (sales not responsive to price change) is incorrect, and sales are actually responsive to price changes. Assume the price elasticity is actually equal to minus 1.0 (the percentage increase in price is matched by an equal percentage decrease in

sales). The increase in the price of boats attributable to the tax is 4.2 percent.[5] In these circumstances, the 4.2 percent average price increase from the luxury tax would imply 4.2 percent reductions in luxury units sold (from 9,100 in 1990 to 8,718 in 1991) and in total revenue from luxury boats (from $1.557 billion to $1.491 billion). For the boat industry as a whole, these reductions would represent percentage decreases of 0.08 percent (less than one-tenth of one percent) of total units sold and 1.4 percent of total revenue.

The model does suggest, however, that income changes, both individual and corporate, have an effect on luxury boat sales. Over the 1970 to 1990 sample period, each one percent decrease in real disposable personal income has been associated with a 1.8 percent decrease in sales and total revenue; each one percent decrease in real after-tax corporate profits with a 0.4 percent decrease. Real personal disposable income dropped from the second quarter of 1990 to the first quarter of 1991 by 1.4 percent, suggesting 2.5 percent reductions in luxury boat units sold and total luxury boat revenue. Real after-tax corporate profits grew by 1.1 percent from 1990 to 1991 (forecast), suggesting a 0.4 percent increase in sales and revenue. The combined effect of these two income changes suggests about a 2.1 percent decrease in sales and revenue. When adjusted for luxury boat industry share, the expected effect in 1991 is a 0.04 percent reduction of industry sales and a 0.71 percent reduction of total revenue.

The bottom line here is that in spite of all the talk about a recession, real disposable personal income has declined very little in the last year and corporate profits are actually forecast to increase. According to the model estimates, the large decrease in luxury boat sales is not attributable to either the luxury boat tax or changes in real disposable personal income for the entire population. It is worth pursuing the extent to which the decrease in disposable personal income of the portion of the population that purchases luxury boats may have exceeded the decline for the population as a whole, as well as the influence of the used boat market on the demand for new boats.

ESTIMATION ISSUES

Two possibilities might lead us to question the zero estimate of price elasticity from the equations. First, one might ask if there is sufficient variation in the price variable to give it a "statistical" chance to be significant. In other words, if the price variation over the sample period was inconsequential, finding a zero coefficient is predictable and accurate. A zero coefficient estimated in

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[5] Note that the price elasticity estimated in the model reflects the change in relative price (the extent to which the nominal increase in boat price exceeds or falls short of the rate of inflation). The CPI in 1991 is forecast to increase by 2.9 percent between the last quarters of 1990 and 1991, which might suggest that the real price of boats increased by 4.2 - 2.9 percent, or 1.3 percent. But boat prices are rising for reasons other than the luxury boat tax, and it is assumed the inflation rate is netted against the non-excise tax portion of the boat price increase.

such circumstances would not, however, be evidence that a substantial price increase imposed by a tax would also have a zero effect on quantity demanded.

Fortunately, price does vary adequately over the sample period. The average real relative price over the sample period was $92,442; and the mean of the absolute value of annual price changes over the period was $5,194. These values translate to an average annual percentage change in price equal to 5.6 percent, greater than the 4.2 percent average tax imposed on luxury boats. It is important to remember that the luxury tax is a 10 percent tax on the portion of sale price in excess of $100,000. A boat selling at $200,000 prior to the tax would experience a supply price increase of $10,000 and a percentage price increase of 5 percent. In contrast, a $125,000 boat would experience an increase of $2,500 or 2 percent. It is clear that the typical boat's price increase attributable to the luxury tax would be well within the range of price variation covered by the 1970 to 1990 sample.

The second possibility is that the model is not properly specified and the true relationship between price and quantity demanded has not been estimated. The question being asked here is, assuming a stable demand schedule, how much will quantity demanded respond to a shift in the supply schedule caused by an excise tax on boats. The model attempts to answer this by estimating a statistical relationship between price and quantity changes from 1970 to 1990. The estimated price elasticity would be biased if the observed price of boats reflects shifts in the demand schedule as well as the supply schedule--the demand schedule would not be properly "identified."

This identification issue is not a problem if the boat industry operates under conditions of constant cost within the relevant range of production, a reasonable assumption for many industries that constitute a relatively small share of the economy and are not extremely capital intensive. Under these conditions, the supply-schedule is horizontal at the market price, and a shift of the demand schedule has little effect on market price. If, however, the industry is characterized by increasing production costs over the relevant range, the price elasticity in the model suffers from "simultaneous equations bias" (the price variable is simultaneously determined with the quantity variable and is correlated with the error term). To test for this bias, the model was reestimated using "two-stage least squares" (essentially this means specifying a supply equation, using all variables other than price and quantity in the demand and supply equations to estimate a new "predicted" price variable, and substituting this "predicted" price variable for P in the model). If simultaneous equations bias exists, the variables in the model should be improved and make more economic sense. In fact, the opposite occurs. The price elasticity becomes positive (and insignificant) and the income variables become negative (and insignificant). It appears that the "predicted" price series (calculated on the assumption of an upward sloping supply schedule) introduces more error than may be present in the potentially biased P.

COMMUNICATIONS

[COMMENTS ON TAX-EXEMPT BILLS—S. 90, S. 150, S. 284, S. 913]

AMERICAN CONSULTING ENGINEERS COUNCIL,
Washington, DC, June 11, 1991.

Hon. DAVID BOREN, *Chairman,*
Subcommittee on Taxation,
Committee on Finance,
U.S. Senate, Dirksen Senate Office Building,
Washington, DC.

Dear Mr. Chairman: The American Consulting Engineers Council (ACEC) is pleased to submit testimony in support of S. 90, The Environmental Infrastructure Bond Act of 1991. We believe passage of this bill is critical to the attainment of several national objectives: the restoration of incentives for private investment into critical environmental infrastructure projects, the improvement of our international competitiveness through increased productivity, the resuscitation of the financial health of U.S. cities, counties, and states, and the restoration of economic growth through the creation of jobs and investment in plant and equipment.

The 1986 Tax Reform Act attempted to sort out and eliminate abuses in the use of tax exempt bonds by local governments and other special purpose government entities such as tax exempt subsidies to commercial enterprises as a way of luring private investment and commercial spending into their communities. Sports arenas, convention centers, and parking facilities were the types of projects whose excesses led to the reform.

The Congressional and IRS intent, however, went beyond reform and emphasized maximization of revenue in order to offset revenue loss in other "reforms" in the bill. The consequence has been a 50 percent decline in bonds in the years immediately following the imposition of the law in 1987. The result of the statutory definition and the implementing IRS has been a virtual elimination of many projects for pollution control and environmental compliance with federal requirements. The primary limitation has been a draconian definition of "private activity" that requires all projects to be classified as private activity projects where more than five percent of "benefit" of the project is allocated to a private entity, that is a trade or business other than a governmental unit. Moreover, the imposition of this restrictive private entity designation has further limited environmental infrastructure by the creation of the state volume cap, which limits private activity bonds to $50 per capita or $150 million. Based on this further limitation, most states are now at or near the cap.

S. 90, introduced originally in the last Congress as S. 700, preserves the reform of the 1986 Tax Reform Act, while providing the reasonable incentives for state and local governments to attract private capital for vital environmental compliance projects. It does this by retaining the 95% rule but redefining the "public." The facilities covered are specific to those which are required to comply with regulations of the U.S. EPA. It also modifies the arbitrage and obligation rules to conform with the more realistic practice for the design and construction of facilities, and, further, it establishes modified depreciation rules for infrastructure facilities.

WHY IS S. 90 SO IMPORTANT?

(a) Incentives for private investment into infrastructure

The traditional method of capital finance for state and local facilities is debt securities tied either to the general full faith and credit of the governmental entity or a

dedicated revenue stream based on fees that are derived from the service which the facility provides (wastewater treatment, drinking water, solid waste disposal). The last decade was one in which solid conservative tax-free public investments became masse in the face of corporate junk bonds and 12 percent S&L accounts. It is time to restore investment in our own communities as a solid personal and institutional investment choice. One of the critical consequences of the 1986 tax change is that municipal securities became much less desirable for institutional investors. According to the Public Securities Association, banks have reduced their holdings by more than $100 billion because of the arbitrage limitations on deductibility of interest. Insurance companies have likewise cut their portfolios of municipal securities. If local and state governments can rely only on private investors, bond subscriptions must offer high interest rates and the market capacity for these important securities must shrink. Is this the public policy we want to foster?

The foreclosure, moreover, of the private investment sources for environmental compliance can only increase demand for direct federal financial support for grant programs to meet federal environmental standards. Do we really want to return to the multiplicity of federal grants with all the costly federal requirements they entail? These are political decisions, not market or economic choices. The wastewater construction grant program was beset with unnecessarily long delays and changing rules. That program is phasing out into a revolving loan program which ACEC has consistently supported. But the political pressure to return to direct federal financing is inevitable to meet federal requirements. Deficit pressure is no restraint. S. 1081, the Senate proposal to reauthorize the Clean Water Act, contains a new $2 billion plus grant program. A healthy and reasonable private investment option is the only sound alternative.

(b) Increased productivity through infrastructure investment

Conventional wisdom in the 80s suggested that prosperity and growth resulted from maximizing investment in the private sector. However, recent analysis suggests that investment in public facilities has a direct impact on national productivity and, thereby, competitiveness. A study published this year by the Economic Policy Institute entitled *Public Investment and Private Sector Growth* by Dr. David A. Aschauer concludes that the decline in infrastructure investment between 1970 and 1985 has paralleled the decline in productivity in the private sector. Further he concludes that comparison among the industrialized nations shows increased infrastructure investment yields higher productivity (see chart following). In fact, Aschauer's calculations demonstrate that the return on private capital would actually have *increased by 2%* if U.S. infrastructure spending had remained at the 1970 level. Further, productivity growth, he concludes, would be at 2.1% for the period 1970-88 rather than the dismal 1.4% it has sunk to. S. 90 would help reverse this trend and improve our infrastructure deficit as well as private productivity.

(c) Resuscitate the financial health of U.S. cities, counties, and states

The bankruptcy of the City of Bridgeport, CT, is only the latest and most shocking of the stories of extraordinary deficits by state and local governments. Much of this is, of course, due to the collapse of the real estate industry in many communities. But it is also related to the reliance by governments on income sources, such as lottery proceeds, which are not reliable and tied to fluctuating consumer habits. This is particularly critical when capital spending is a function of fluctuating revenue sources. Sewer, water, and waste collection revenues are relatively recession proof and have always been seen as stable for bond repayment. S. 90 would create the solid debt financed revenue bonds which permit localities to meet the long term capital needs of environmental compliance.

(d) Restoration of economic growth through job creation and private investment

When asked what factors cause industry and businesses to locate in a community, the availability of adequate capacity in sewer, water, waste disposal, and other local utilities is always near the top of the list. The ability of communities to plan for growth to attract new residents and businesses is a key factor in job creation and expansion of the tax base. Federal policy to support capital long term planning through the tax code has been a key factor in post World War II growth. The change in this policy implemented in the '86 law cannot stimulate new growth, but, in fact, is likely to reduce opportunities for new job creation. S. 90 will restore the ability of communities to have a reliable source of reasonable cost capital for environmental compliance facilities that will provide the capacity for growth, as well as assure the quality of life to make them desirable places to live.

The Joint Committee on Taxation estimated that S. 90 would produce a short term revenue demand of a few hundred million dollars. Isn't that worth the im-

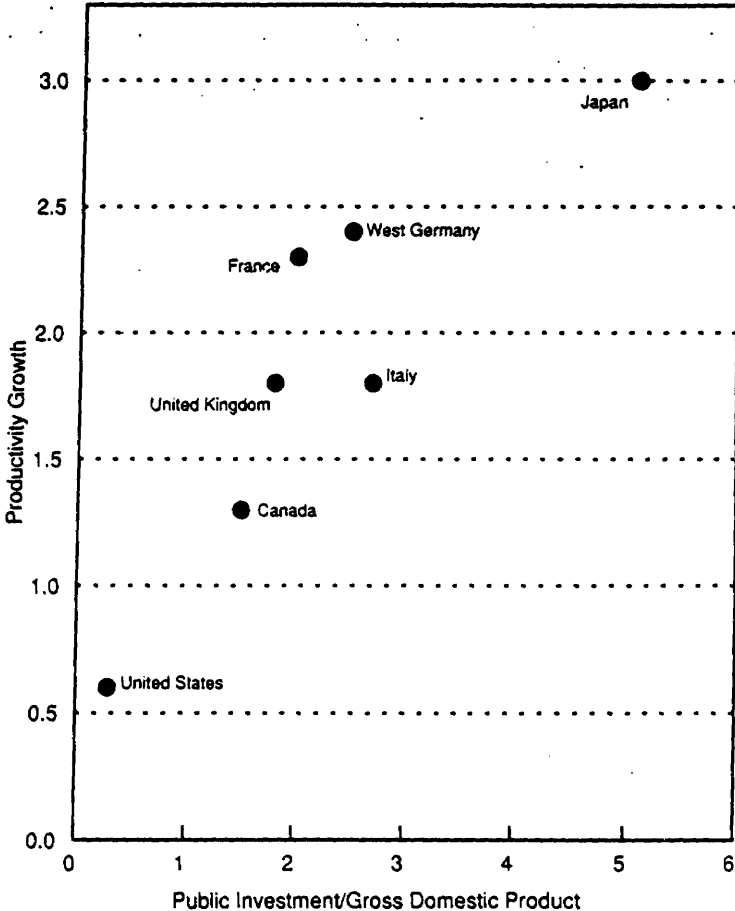
proved environmental compliance, international competitiveness, job growth and quality of life that it will mean for hundreds of communities, large and small? The American Consulting Engineers Council thinks so.

We urge favorable consideration of S. 90 and speedy passage in the Senate.

Sincerely,

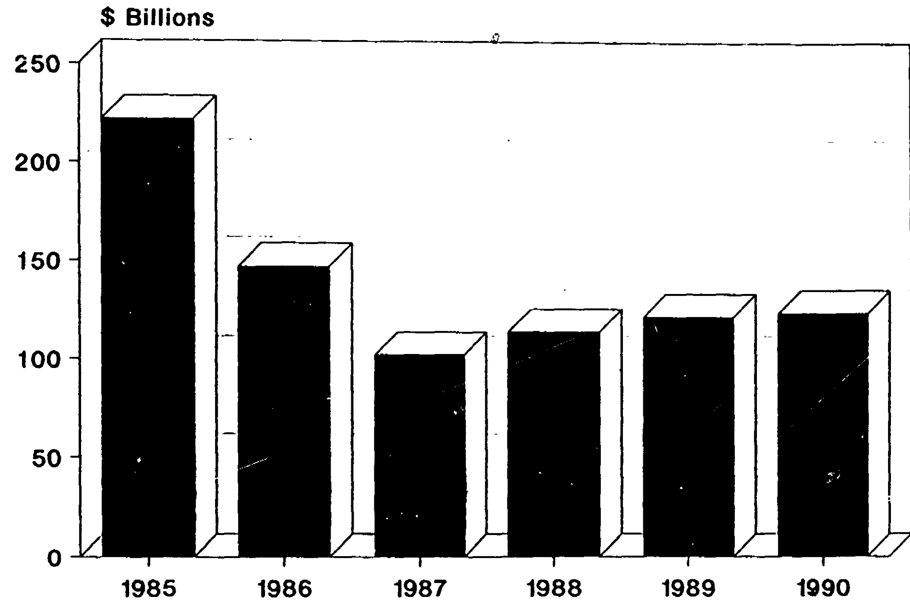
ANDREW J. PARKER, JR., *President, American Consulting Engineers Council.*

Figure 7
Cross-Country Comparison of Productivity Growth and Public Investment to GDP Ratio



(Source: Author's calculations.)

A cross-country comparison of average annual growth rates of labor productivity with the ratio of public investment to gross domestic product indicates that over the period 1973–1985, nations which invested more in their public capital stocks saw productivity gains as well.



Source: IDD/PSA Municipal Database

THE CITY OF NEW YORK

Statement of David N. Dinkins, Mayor of the City of New York and Elizabeth Holtzman, Comptroller of the City of New York

We are pleased to submit these comments on behalf of the City of New York (the "City") in connection with proposals currently before your committee to change the provisions of the Internal Revenue Code (the "Code") with respect to tax-exempt bonds. It is our understanding that in many respects these proposals reflect the work of various groups, including a commission to study tax-exempt financing organized by Congressman Beryl Anthony (the "Anthony Commission"), to reexamine certain provisions of the Tax Reform Act of 1986 (the "1986 Act") relating to tax-exempt financing.

As you may know, after years of deterioration of the City's infrastructure and capital facilities following the New York City fiscal crisis of 1975, the City in 1986 announced a 10 year capital program which contemplated the issuance of approximately $2.5 billion in tax-exempt debt annually. This program was increased in 1988, but recently was scaled back somewhat in 1990. As a result of this program, the City has been the largest municipal issuer of tax exempt debt in the country. As such, the City strongly supports the efforts of the Anthony Commission and other groups to have Congress reexamine the provisions of the Internal Revenue Code relating to tax-exempt financing. S.913 introduced by Senator Baucus incorporates many of the recommendations of the Anthony Commission.

General Statement

Although the Committee has before it many proposals of interest to the City of New York, this statement concerns only the proposals relating to tax-exempt financing.

As a general matter, the City wholeheartedly endorses proposals to reduce the burdens of the 1986 Act on legitimate issuers of tax-exempt financing, including S. 90, introduced by Senators Boren and Domenici, and S. 150, introduced by Senator Moynihan. While the City fully understands the desire of Congress in the 1986 Act to eliminate abuses by certain issuers of tax-exempt debt under prior law (which abuses involved attempts to earn an arbitrage profit or to benefit private businesses rather than municipalities), it has been the City's experience that the provisions of the 1986 Act relating to issuance of tax exempt obligations went far beyond what was necessary to eliminate such abuses. In many cases, the City has found that the provisions of the 1986 Act preclude its ability to finance legitimate municipal activities with tax-exempt debts. In addition severe administrative burdens have been placed on City personnel in complying with these provisions, and the cost of such compliance in many cases is wholly disproportionate to the benefits achieved.

A further problem with many provisions of the 1986 Act is that the City, its bond counsel, and ultimately the IRS and the Treasury Department, have had significant difficulty in interpreting them, as applied to a large issuer like the City. For the first fourteen months, after the Act was issued, from September 1986 until October 1987, the City was unable to issue any long-term tax-exempt debt financing new facilities at all. The issuance of IRS Notice 87-69 in October 1987 did clarify certain issues so that the City could go forward with the tax-exempt financing of general municipal capital projects. Unfortunately, even five years after the passage of the 1986 Act, there remain many unanswered questions, and the uncertainties surrounding these provisions place a significant burden on the City and its taxpayers.

Many facilities which the City strongly believes should have been financed on a tax-exempt basis have had to be financed with taxable debt because of uncertainties surrounding the definition of "private loan bonds", and the unreasonable restriction on private loan

bonds applicable to large issuers. The City's recent experience has been that the Internal Revenue Service is having significant difficulty in resolving these uncertainties.[1] The City has in the past four years been forced to in excess of $1 billion in taxable debt. Many of the projects financed with this debt involved capital grants or low-interest loans to homeowners and private developers of low-income housing. The City believes that these projects carry out essential government functions of providing decent housing for low-income people and should properly have been financed on a tax-exempt basis. It is only because of the discriminatory and unfair restrictions on large issuers and the legal uncertainties as to what constitutes a loan bond that the City has had to issue such a large amount of taxable debt.

The City therefore believes that reforms to Sections 141 to 150 of the Code are necessary to permit the legitimate issuance of tax-exempt municipal bonds for public purposes. As a general matter the City supports the proposals to liberalize these provisions.

The City notes, however, that a number of the proposals in S. 913 are intended to provide relief to small issuers. While it has no objection to such proposals, it strongly believes that the Committee should additionally consider, both as a matter of equity and balance, at least one proposal, discussed below, which it believes will provide significant relief to large issuers.

Specific Comments:

A. S. 913 Proposals

The proposals in S. 913, as we understand them, would liberalize the current law as follows:

(1) The $5 million small issuer exemption from rebate in Section 148(f)(4) would be increased to $25 million;

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[1] On December 7, 1989, the City, on the advice of its bond counsel, filed a request for an IRS private letter ruling that a number of its programs involving grants or below market interest loans to private homeowners and developers of low-income housing are not in violation of the private loan restriction. Eighteen months later the issues in that ruling have yet to be resolved.

(2) The 2-year spend down provision in Section 148(f)(4)(iv) would be made retroactive to August 15, 1986;

(3) The small issuer exception from the interest expense disallowance of Section 265(b)(3) would be increased from $10 million to $25 million;

(4) The 5 percent test for private business use not related or disproportionate to government use financed by the issue in Section 141(b)(3) would be repealed;

(5) Section 148 would be amended to permit the payment of rebate in lieu of restricting yield on investment of bond proceeds;

(6) Section 148 would be amended to reduce the amount to rebate from 100 percent to 90 percent of arbitrage earned;

(7) Certain advance refunding transactions would be prohibited.

B. City Position

1. Committee Proposals

While as noted above the City generally supports all liberalizations of the 1986 Act, proposals (1) and (3) above relating to the small issuer exception do not help alleviate the City's problems at all, and the impact on the City of proposal (2), allowing the retroactive application of Section 148(f)(4)(iv), is marginal at best.

The City strongly supports proposal (4) calling for the repeal of the 5 percent test for unrelated business use. The determination of related as opposed to unrelated use as well as the proportionality test has been very difficult for the City, and does not seem to advance the purposes of the statute. Elimination of this requirement will enable the City and other issuers to have greater flexibility in allocating debt proceeds, and obviate the need for expensive tracking of related and unrelated use.

Proposal (5) relating to rebate will, in lieu of yield restrictions, be of some benefit to the City to the extent that it has had to restrict the yield on the investment of bond proceeds in accordance with the statute and the regulations. It is unclear at this time, whether and to what extent, if at all, the City will have to pay rebate. As a policy matter, the City believes that the dual

requirement of both yield restriction and 100% rebate payments on arbitrage earned in excess of the statutory and regulatory safe harbors is unnecessarily restrictive. We have no objection to the Treasury's proposal that there be residual authority to impose both requirements to prevent abuse. The City also supports proposal (6) to reduce the amount of rebate required from 100 percent to 90 percent of arbitrage earned.

The City is not affected by the seventh proposal, but it believes it to be sound tax policy.

b. Additional Proposal.

There is one additional proposal that the City strongly believes the Committee should consider. This relates to the limitation on private loan bonds in Section 141(c). As you know, Section 141(c) currently limits the amount of the proceeds of a tax-exempt issue that can be loaned to a private party to the lesser of 5% of an issue or $5 million.

The City urges that Section 141(c) be amended to eliminate the $5,000,000 per issue restriction and limit the definition of private loan bonds to issues in which more than 5% of the proceeds are used to make private loans.

While this change would not affect any municipality that issues less than $100,000,000 per issue, it would permit the few large issuers, such as the City, that find it is not economically feasible to issue debt in amounts of less than $100,000,000, to operate under the same restrictions (i.e., no more than 5% of an issue may be private loan bonds) as smaller issuers. Under current law, a large issuer like the City that, on the advice of its lead underwriters, has had two issues in excess of $1 billion in the past year, is limited to using only 0.5% of an issue for private loan bonds - one-tenth what a smaller issuer can use.

The 1986 Tax Act limited the amount of proceeds to be used for loans to the lesser of 5% or $5 million to reduce the diversion of government loan proceeds to conduit financing of non-governmental users. It was not intended to affect the availability of tax exempt financing for traditional governmental activities. In the City's case,

the private loan restriction prevents the use of tax-exempt capital financing for legitimate municipal programs which involve financing private developers to carry out municipal functions. The City's low-income housing programs, for example, which were structured prior to the 1986 Tax Act, generally involve loans, or grants with enforcement liens, to private homeowners and, in some cases, to private developers of low-income housing. These programs were patterned on the federal interest subsidy housing programs of the late 1960's. As the programs were coming to fruition in 1986 and 1987, the City was advised by its bond counsel that some of the elements of these programs, involving loans or grants to private contractors to build municipality subsidized and regulated private housing for low-income families, might be considered private loan bonds. Given this uncertainty and the restrictive $5 million limit on private loan bonds, the City has been forced to finance significant portions of its program on a taxable basis. The City has thus since 1986 been faced with a situation in which important elements of its major program to combat the growing problem of homelessness can only be financed with taxable debt, because of the arbitrary and discriminatory operation of limitations in Section 141(c) of the Code. The $5 million limitation permits smaller municipalities greater flexibility in structuring these kinds of loan subsidy programs than that afforded a larger municipality like the City of New York, even though the needs and problems of larger cities in dealing with homeless populations and unemployment are in many ways more pressing.

Furthermore, as indicated above, the City has long contended that a significant portion of the funds advanced under many of these programs are not in fact loans but are grants and thus are not in fact private loans within the meaning of Section 141(c). However, the IRS has yet to so rule. The City believes that lifting the loan bond restriction from $5,000,000 to 5% of an issue will significantly alleviate the necessity for the City, the IRS and other issuers to have to make these kinds of determinations as to what constitutes a "loan".

Limiting large issuers to the same percentage limitations as smaller issuers will lift the unfair and discriminatory burden which the 1986 Tax Act places on the large cities of this nation. To the City, this latter proposal is of significantly greater benefit and importance than all others advanced in S. 813. It urges that it be incorporated into any bill that is reported.

COLORADO WATER RESOURCE & POWER DEVELOPMENT AUTHORITY,
Denver, CO, June 21, 1991.

Mr. WAYNE HOSIER,
U.S. Senate,
Committee on Finance,
Washington, DC.

RE: Written Testimony Regarding Public Hearing on June 12, 1991, Subcommittee on Taxation, Senator David Boren, Chairman.

Dear Mr. Hosier: The Colorado Water Resources and Power Development Authority has established two pooled-loan programs to assist cities, towns and districts with the financing of their water supply and wastewater infrastructure needs. The Authority is the Administrator of the Water Pollution Control Revolving Fund (WPCRF), a revolving fund established to receive capitalization grants from the U.S. EPA under the Clean Water Act of 1987. The Authority pools the needs of several borrowers and then issues tax-exempt bonds to fund loans.

Most of the borrowers in our programs, with the exception of a few large borrowers in the WPCRF, issue less than $10 million of tax-exempt bonds per year. On their own, these cities, towns and districts are bank-qualified and benefit from tax law provisions that permit banks to deduct a portion of the cost of carry of small-issuer bonds. When qualifying small-issuer bonds are purchased by banks that pass along a portion of these tax benefits to the issuers, the rates on these bonds may be anywhere from 5 to 35 basis points less than if they were purchased by non-bank investors and institutions.

Under current tax law, borrowers that participate in the pool lose their bank-qualified status and the bank deductibility benefits. Therefore, a small issuer must sacrifice lower rates associated with bank qualification to take advantage of economies of scale and national market access inherent in participation in a pooled issuance.

The enclosed proposal would amend the tax code to permit the limited pass-through of bank-qualified borrowing to participants in a pool. This benefits both the small issuer and the U.S. Treasury. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service costs. For the U.S. Treasury, fewer tax-exempt bonds would mean a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

Financing water supply and wastewater infrastructure to meet the Safe Drinking Water Act and Clean Water Act requirements is an important issue facing Colorado's cities, towns and districts. This amendment would represent one small step in decreasing the costs associated with these requirements.

I feel this proposal supports efforts to simplify tax code provisions, assists small issuers in meeting their demands for infrastructure improvements, and gives these same issuers a vehicle for accessing national financial markets that otherwise may not be available to them.

Senator Max Baucus and Representative Beryl F. Anthony are currently initiating tax code simplification measures on behalf of tax-exempt small issuers. I believe this proposal would support and complement those efforts.

If you have any questions about this proposal, please feel free to call.

Sincerely,

DANIEL L. LAW, *Executive Director.*

Enclosure.

THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

SUMMARY

The United States Senate Finance Committee and House Committee on Ways and Means are considering comments and developing proposals on how federal tax code provisions can be simplified and made more efficient.

This proposal would amend the tax code to permit the limited pass-through of bank-qualified borrowing to small-issuer participants in a pooled issue.

The amendment would allow small issuers of bank-qualified bonds (also known as qualified tax-exempt obligations) to sell their bonds to a pooling issuer, or bond bank, which would then designate and issue an equivalent amount of pool securities as bank-qualified bonds and use the proceeds to buy the small issuers' bonds. Any small-issuer bonds purchased with the proceeds of the bank-qualified pool bonds could not subsequently be designated and sold in the marketplace as bank-qualified bonds.

This benefits both the small issuer and the U.S. Treasury. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service costs.

For the U.S. Treasury, fewer tax-exempt bonds would mean a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

HOW THE PASS THROUGH WOULD WORK

CURRENT LAW: Banks may purchase qualified tax-exempt bonds and deduct 80 percent of the cost associated with the purchase and carry of such bonds. These bonds are sold by tax-exempt entities --the small issuers-- who expect to borrow $10 million or less in a calendar year. Small issuers, who would issue bank-qualified bonds on their own, do not receive this benefit when they participate in a pooled issuance, unless the pool authority itself expects to issue less than $10 million a year.

The value of bank qualification varies over time; the interest rate on a bank-qualified security may be anywhere from 5 to 35 basis points lower than an identical bond that is not bank qualified, depending on credit market conditions and the demand of banks for tax-exempt securities.

THE REQUEST: To permit the limited pass-through of bank-qualified borrowing to small issuers participating in a pooled bond issuance.

THE BENEFITS: The addition of bank-qualified borrowing as a pass-through feature supports tax simplification and helps those small issuers targeted for assistance by the staff of the House Committee on Ways and Means -- the "governmental units which are unduly burdened by the administrative complexity of rebate calculations...have difficulty accessing the national debt market at reasonable rates and must rely heavily upon local banks as purchasers of their obligations." [1]

The small issuer <u>and</u> the U.S. Treasury benefit from the pass-through. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from the economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service carrying costs.

For the U.S. Treasury, fewer tax-exempt bonds means a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

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[1] Committee on Ways and Means - U.S. House of Representatives, "Written Proposals on Tax Simplification - Bond-related Proposals", Committee Print - 101st Congress, 2nd Session, May 25, 1990, p. 60.

THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

Bank-qualified borrowing is one of two small issuer exemptions; the other exempts small issuers from arbitrage rebate. As noted in the Joint Committee on Taxation's General Explanation, the small issuer arbitrage rebate exemption can be passed-through to pooled-issue participants. This amendment will result in parallel benefits to small issuers with regard to bank-qualified issues.

DETAILS OF THE PROPOSED TECHNICAL CORRECTION: Local issuers with bank-qualified bonds or loans sell these securities to the bond bank. The bond bank designates and issues an equivalent amount of bond-bank securities as bank-qualified bonds. These bond-bank securities are then sold as bank-qualified bonds and the benefit of lower interest rates on these bonds is passed through to the local issuer. Maturity schedules on the bond-bank securities would be similar to those of the local bank-qualified bonds. The portion of the bond bank issuance that is bank qualified can be processed either as a separate series within an issue or as a separate issue. In the amendment, the publicly offered pooled issue benefits from a lower rate only on the portion of its sale used to purchase bank-deductible obligations, and the interest rate saving will pass through to the qualified small issuers.

The bank-qualified designation would either be retained by the small issuer or passed through to the pooling authority, but would not be available to both. If the bank qualification is used by the pooling authority, the local, small issuer, bonds purchased by the pooling authority may not at some future date be sold as bank-qualified obligations.

What follows is a technical correction to Section 265(b) Internal Revenue code of 1986. The proposed language has been carefully drafted with a view to prevent any perceived potential for abuse this proposal might raise with respect to pooled financing.

THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

THE PROPOSED AMENDMENT

BANK DEDUCTIBILITY:

Subparagraph (A) of Section 265(b)(3) is amended to read as follows:

(A) IN GENERAL - Any qualified tax-exempt obligation acquired after August 7, 1986, and any qualified tax-exempt pooled obligation shall be treated for purposes of paragraph (2) and Section 291(e)(1)(B) as if it were acquired on August 7, 1986.

Paragraph (3) of Section 265(b) is amended by adding to the end thereof the following new subparagraph:

(G) QUALIFIED TAX-EXEMPT POOLED OBLIGATION - For purposes of subparagraph (A), the term "qualified tax-exempt pooled obligation" means a tax-exempt obligation issued as part of an issue

(i) which is not a private activity bond (as defined in Section 141); and

(ii) the proceeds of which are used actually and exclusively
- (I) to purchase obligations
  - (a) which satisfy the requirements of this paragraph [other than the designation described in subparagraph (b)(3)(B)(i)(III)] provided that if the pool issuer has made the designation described in subparagraph (b)(3)(B)(i)(III) none of the issuers of obligations purchased with the proceeds of the qualified tax-exempt pooled obligations of such issue makes the designation described in such subparagraph with respect to such purchased obligations, and
  - (b) the weighted average maturity of which is not less than the weighted average maturity of the qualified tax-exempt pooled obligations of such issue; and
- (II) to pay issuance costs of the qualified tax-exempt pooled obligation.

Statement of the Government Finance Officers Association

INTRODUCTION

The Tax-Exempt Bond Simplification Act of 1991 (S. 913) is strongly supported by the Government Finance Officers Association because it provides a modicum of relief from the overly restrictive limits placed on tax-exempt bonds in the 1986 Tax Reform Act. It also has been endorsed by 27 other organizations representing every segment of the state and local government community in a Legislative Alert sent to all U.S. Senators (attached), and the National Governors' Association has called for its enactment. It is an important first step in correcting the unintended regulatory overkill caused by the Tax Reform Act of 1986.

The need for relief from the costly administrative burdens imposed by the 1986 Tax Reform Act has been well documented and there is a consensus that Congress overreacted to a few reports of perceived abuses. The costs to state and local government associated with these changes have greatly exceeded any benefit to the federal government and, indeed, public resources have been wasted to comply with needless regulation.

Nevertheless, even though there is substantial support for simplification in the Congress as well as in the Treasury Department, we are told that the costs of the changes for the federal government may be prohibitive. We disagree with the rationale for estimating those costs and urge Congress to reject any argument that results in an increased burden to state and local governments which far exceeds any benefit to the federal government.

In these comments, responses are offered to the arguments presented against provisions in S. 913 by the Joint Tax Committee in its pamphlet, "Description of Tax Bills (S. 90, S. 150, S. 267, S. 284, S. 649 and S. 913)."

PROVISION 1: FIVE PERCENT UNRELATED OR DISPROPORTIONATE USE TEST

The five percent disproportionate or unrelated use test is one of four tests used to determine if a bond is classified as a governmental bond or a private-activity bond. The Joint Tax Committee is correct in its assessment that this test effectively lowers one of the other tests (the 10 percent private business use test) to 5 percent. As an example, this test limits the amount of bond proceeds that could be used to build a cafeteria in a school building if the cafeteria was operated privately and the operator made payments to the school district for use of the cafeteria facility.

This is clearly not an abuse of tax-exempt financing and not something Congress sought to curtail in 1986. The 10 percent private business use test is adequate and in 1986 this test was made more restrictive by reducing the percentage from 25 to 10 percent. The effect of the five percent unrelated or disproportionate business use test is that issuers are literally paying lawyers to review architectural plans to verify that the floor space used by private users such as the cafeteria operator is not excessive.

The Joint Tax Committee staff apparently believes that repealing this provision will increase the private activities for which tax-exempt financing may be provided. State and local governmental issuers do not routinely use some portion of their bond proceeds for so-called private purposes. To begin with, these are governmental issues and are subject to review and approval by voters or officials accountable to elected officials. Decisions to undertake such financings are public decisions. Further, we are unaware of any credible information available to the Joint Committee staff on which it based its conclusions. No data collection mechanisms are in place at the federal or state levels.

The Joint Tax Committee staff refers to these financings as "conduits." This is totally misleading. A conduit bond is one where a governmental entity has no responsibility to repay the bond and the private beneficiary is solely responsible. The bonds subject to the five percent disproportionate or unrelated use test are governmental securities for which the governmental issuer is totally responsible for the repayment of the bonds.

The Treasury Department acknowledges that this section is unintelligible. It recognizes that repeal of the five percent rule would accomplish significant simplification without sacrificing significant policy objectives. The Department says it has no objection to repeal if an acceptable offset is provided. We do not, however, believe that there are any measurable revenue consequences to the repeal of this provision because there is no indication that there is significant private use financing provided with governmental bonds and three other current law tests would continue to limit private involvement.

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PROVISION 2: ELIMINATION OF THE YIELD RESTRICTION REQUIREMENT IN CERTAIN CASES

Requiring the yield restriction in those cases where rebate or the 1989 penalty provision apply is completely unnecessary. The yield restriction rules were in place prior to the enactment of arbitrage rebate and a strong argument can be made that members of Congress were not made aware that they were imposing duplicative arbitrage restrictions. Requiring issuers to restrict the yield they earn on bond proceeds that are invested for temporary periods to eliminate the earning of arbitrage at the same time the issuer is subject to rebate can only be described as punitive. The Treasury generally agrees with this position.

It is true as the Joint Committee staff notes that the two restrictions apply to different time periods, but these periods overlap—thus these are overlapping requirements. This belt and suspenders approach cannot be justified, and we point out that it costs the federal government money. If issuers restrict yields on their investments, they are reducing the amount of rebate they must eventually pay to the federal government.

The Joint Committee staff proposal to impose rebate for some prescribed period and then to impose yield restriction thereafter is a step in the right direction. However, we would suggest eliminating rebate altogether, imposing spend-out requirements during the first three years after the bond issuance and then subjecting unused bond proceeds to yield restriction.

ISSUE 3: REDUCTION OF ARBITRAGE PROFITS SUBJECT TO REBATE

Permitting issuers to retain some reasonable percentage of their arbitrage rebate as an incentive for them to maximize investment return is a sound policy. We only question whether 10 percent is a large enough percentage—25 percent may be more appropriate. We subscribe to the view that this is a revenue-raising provision that should be adopted immediately and the revenue raised should be used as an offset for other bond relief provisions. The Treasury Department believes the proposal merits serious consideration. The Joint Committee staff concern that this change could lead to earlier and larger issuances of tax-exempt bonds is simple paranoia.

The concept of arbitrage sharing is one we believe should be explored more fully. It may be possible to develop a streamlined arbitrage compliance system with issuers and the Treasury sharing arbitrage profit in exchange for extremely simplified compliance requirements.

POSITION 4: INCREASING THE SMALL-ISSUER REBATE EXCEPTION

Increasing the small-issuer rebate exception provides relief to those governments most in need. A large number of issuers account for a small amount of total dollar volume so it is possible to provide a substantial amount of simplification at little cost. As the graph on the following page so vividly illustrates, 89.5 percent of all municipal issues in 1990 were less than $25 million, but these accounted for only 28.6 percent of total municipal volume. It is safe to say that the governmental bonds eligible for this exception are not arbitrage-motivated. These bonds are for core governmental facilities such as schools, streets, city halls, fire trucks, etc.

There are several other reasons to increase this exception. Small issuers go to market infrequently and when they do, they often package several projects together to reduce issuance costs. Issuers whose total annual borrowing exceeds the $5.0 million limit should not be forced into more frequent and costly borrowing practices. It has been five years since the arbitrage rebate was enacted and project costs have escalated during that time. The $5.0 million limit is now less adequate than ever. The existence of computer programs for calculating rebate does not simplify the rebate requirement substantially. The Joint Committee staff fails to point out that the source of complexity is the mind-boggling tracking of investment and expenditure transactions through the accounting system and the collection of the data that is used in the computer program. The actual calculation of rebate is not a significant compliance problem.

Another reason to expand this exception is because other options that were to be made available to issuers are not viable options. For example the Treasury Department's State and Local Government Series (SLGS) program was intended as a meaningful rebate safe harbor. Treasury has been unable to date to fulfill the intent of the law which was adopted with issuer support in 1986. Rigid administrative requirements limit the utility of the program, and the federal government fails to provide a reasonable return on the investment of bond proceeds.

PROVISION 5: RETROACTIVE RELIEF FOR CERTAIN CONSTRUCTION BOND ISSUES

The burdens and complexity of the arbitrage rebate which Congress recognized and responded to in 1989 by enacting the two-year rebate exception should not be imposed on any bond issuer. Congress should provide relief to issuers who must comply with an unworkable requirement. Issuers should be given the option of complying with the two-year requirement and not saddled with up to 15, 25 or 35 more years of rebate compliance.

PROVISION 6: EXPANSION OF FINANCIAL INSTITUTION SMALL-ISSUER EXCEPTION

The bank interest small-issuer exception should not be viewed simply as an unnecessary tax subsidy to financial institutions as the Joint Tax Committee staff proposes. This is a method of finance used by many small jurisdictions that do not have access to the national capital markets to finance their infrastructure and other public facilities. The Joint Committee staff misses the point that issuers who rely on local banks are incurring lower issuance costs. If the banks cannot use the deduction, borrowers have to find other purchasers and, in other instances, they have to pay higher interest costs to the banks which means more tax-exempt borrowing is outstanding.

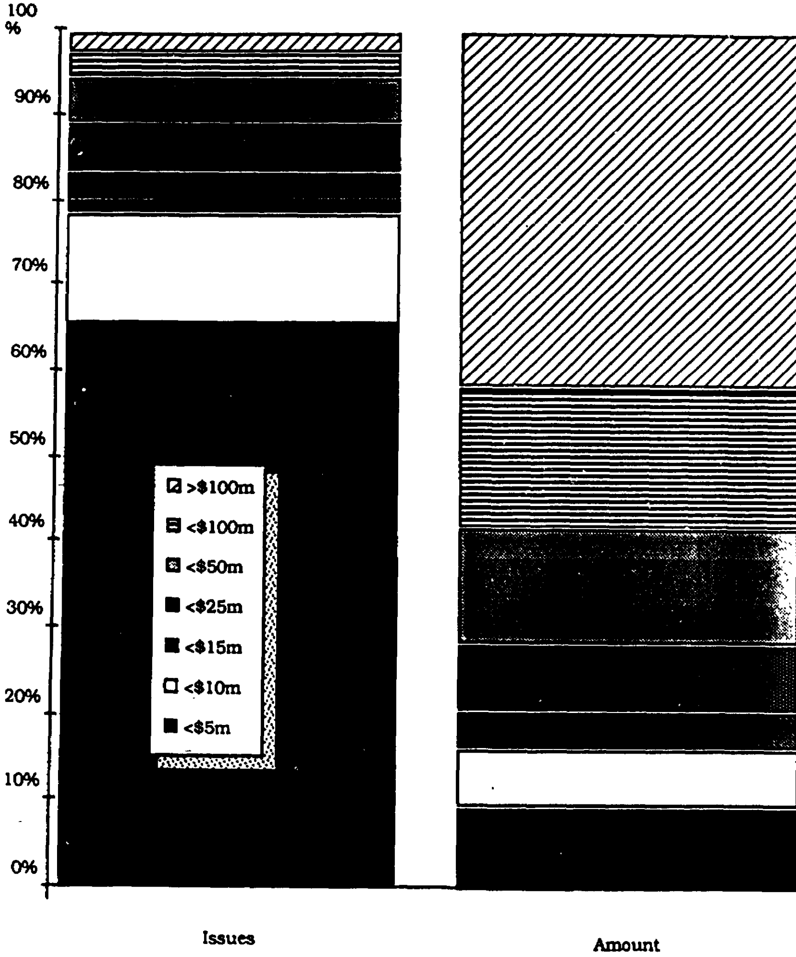
The availability of the interest deduction permits banks to offer lower-cost financing to governmental entities most in need. There is another advantage that should not be overlooked. Bank investments in municipal bonds are stable investments. It is in the national interest to provide banks with incentives to invest in municipal bonds rather than risky real estate and other investments that have been the cause of the recent financial crisis in the banking industry.

The bank interest deduction provision was not treated as a tax-exempt bond provision in 1986—it was a banking provision. Therefore any revenue loss associated with a change in this provision should not be associated with tax-exempt bonds in 1991.

The Joint Tax Committee staff points to the growth of individual investors in tax-exempt bonds as the solution to the marketing difficulties historically addressed by bank and other financial institution purchasers. In other words, the banks were the buyers of last resort. The strength of individual investors in the last few years should not be assumed to be a long-term trend. If other competing investment vehicles are made available and faith in the stock market is fully restored there could be a reduction in individual demand resulting in considerable volatility in the municipal market.

Questions concerning these comments should be directed to Cathy Spain or Ruth Wallick, Government Finance Officers Association, 1750 K St., NW, Washington, D.C. 20006 (202) 429-2750.

1990 Municipal Issues



Source: Government Finance Officers Association

Legislative Alert

from

Airport Operators Council International
American Association of Port Authorities
American Association of School Administrators
American Association of State Colleges and Universities
American Planning Association
American Public Gas Association
American Public Power Association
American Public Works Association
Association of Local Housing Finance Agencies
Association of Metropolitan Sewerage Agencies
Association of Metropolitan Water Agencies
Council of Infrastructure Financing Authorities
Government Finance Officers Association
International Bridge, Tunnel and Turnpike Association
International Institute of Municipal Clerks
Municipal Treasurers Association
National Association of Counties
National Association of Development Organizations
National Association of Elementary School Principals
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Treasurers
National Conference of State Legislatures
National Council of Health Facilities Finance Authorities
National League of Cities
National School Boards Association
Public Housing Authorities Directors Association
U. S. Conference of Mayors
Water Pollution Control Federation

TO: United States Senators

DATE: May 8, 1991

SUBJECT: S. 913 -- a Bill Introduced by Senators Baucus, Dodd, Boren and Riegle

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ACTION NEEDED: The national public interest groups listed above urge you to co-sponsor S. 913, introduced by Senators Baucus, Dodd, Boren and Riegle which provides relief from some of the overly restrictive provisions on the ability of state and local governments to finance critical infrastructure projects.

THE LEGISLATION: The legislation seeks to simplify provisions authorized as part of the 1986 tax reform law which adversely affect the ability of state and local governments to finance vital public capital projects. In fact, the bill addresses several of the suggestions made by the Joint Tax and the Ways and Means Committees in their 1990 reports on tax simplification.

Specifically, the legislation, if enacted, would make changes in the tax-exempt bond area that would relieve governments from administrative and financial burdens and provide some incentives to institutional investors to purchase bonds sold by small governments to pay for needed infrastructure.

Tax-exempt bonds are the major financing tool used by state and local governments to build schools, roads, jails, hospitals, solid waste projects and other public facilities. The simplification measures contained in S. 913 would, although incremental, go a long way in assisting states, counties, cities and other governmental entities in providing these important public services throughout the country.

S. 913, as drafted, would:

- raise the small-issuer arbitrage rebate exception from $5 million to $25 million;
- permit issuers to retain 10 percent of the rebate owed as an incentive to maximize investment earnings;
- raise the small-issuer bank interest deduction exception from $10 million to $25 million;
- make the arbitrage rebate relief provision enacted in 1989 retroactive to bonds issued after August 31, 1986;
- repeal the five percent unrelated or disproportionate use rule; and
- eliminate the yield restriction requirement if the issuer complied with the rebate requirement.

Clearly, these simplification measures are not major spending proposals, and once again, we urge you to support S. 913 as a sure way to help your state and local governments provide necessary public services in a cost-effective manner.

Thank you for your support, and we look forward to working with you. If you have any questions, please contact Cathy Spain or Joanne Field, Federal Liaison Center, Government Finance Officers Association, 1750 K Street, N.W., Suite 200, Washington, D.C. 20006. (202/429-2750).

STATEMENT OF THE NATIONAL RURAL WATER ASSOCIATION

Thank you very much for allowing the National Rural Water Association and its 45 state affiliate organizations to testify before your Committee today. Our organization represents over 10,400 small community rural water and sewer systems in the 48 contiguous states.

The purpose of our testimony is to strongly support the passage of S. 90. Our primary reason for this support is that small communities and rural water and wastewater systems are in great need of financial assistance in order to modify existing facilities or construct new facilities to meet the expanding federal environmental protection requirements.

The size of the problem faced grows each month. Initial estimates for the cost to comply with only the first requirement of the Safe Drinking Water Act were over $3.0 billion for small systems. With each new contaminant covered by EPA, the cost will grow. With the federal Farmers Home Administration (FmHA) grant and loan program funded at less than one-third of this level, small communities will not be able to meet these environmental protection needs without access to private financial markets.

We would like to raise one additional issue that we are requesting that you consider in this bill. We are requesting that these provisions of the tax code be extended to non-profit rural water systems that are eligible for grants or loans from FmHA. Many of our rural water and sewer systems are not specifically units of local government, but they do serve as the water or sewer utility for the wide geographic area they serve. Their inability to obtain bonding authority because of tax code restrictions has caused a serious financial disadvantage to many rural areas of our country. I would urge you to modify the IRS code to allow small FmHA eligible rural water and sewer systems to be treated as units of local government for federal tax purposes as defined by Section 115(c).

Thank you very much for the opportunity to testify and we urge the speedy passage of this bill.

NEW HAMPSHIRE MUNICIPAL BOND BANK,
Concord, NH, June 17, 1991.

Hon. DAVID BOREN,
U.S. Senate,
Hart Senate Office Building,
Washington, DC.

Dear Senator Boren: I am writing to ask for your support for the enclosed proposal which would provide pass-through of "bank deductibility" to participants in a pooled bond issue. Please consider this letter and the enclosed proposal as written testimony to your Subcommittee on Taxation's public hearing held June 12, 1991.

Participants in a pooled financing, according to current law, lose their "bank qualified" status and the bank deductibility benefits. Therefore, a small issuer must sacrifice lower rates associated with bank qualification to take advantage of economies of scale and national market access inherent in participation in a pooled issuance.

The enclosed proposal would amend the tax code to permit the limited pass-through of bank-qualified borrowing to participants in a pool. This benefits both the small issuer and the U.S. Treasury. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service costs. For the U.S. Treasury, fewer tax-exempt bonds would mean a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

We feel this proposal supports efforts to simplify tax code provisions, assists small issuers in meeting their demands for infrastructure improvements, and gives those same issuers a vehicle for accessing national financial markets that otherwise may not be available to them.

Sincerely,

HOYT A. HANEY, *Executive Director.*

Enclosures.

BANK DEDUCTIBILITY

Subparagraph (A) of Section 265(b)(3) is amended to read as follows:

(A) IN GENERAL - Any qualified tax-exempt obligation acquired after August 7, 1986 or any qualified tax-exempt pooled obligation shall be treated for purposes of paragraph (2) and Section 291(e)(1)(B) as if it were acquired on August 7, 1986.

Subparagraph (F) of Section 265(b)(3) is amended by adding to the end thereof the following new sentence:

For purposes of this subparagraph (F), the term "composite issue" shall not include any qualified tax-exempt obligation merely by a reason of its purchase by a pooled issuer.

Paragraph (3) of Section 265(b) is amended by adding to the end thereof the following new subparagraph:

(G) QUALIFIED TAX EXEMPT POOLED OBLIGATION - For purposes of subparagraph (A), the term "qualified tax exempt pooled obligation" means a tax-exempt obligation issued by a pooled issuer as part of an issue

(I) which is not a private activity bond (as defined in section 141);

(II) the proceeds of which are actually and exclusively used to acquire one or more qualified tax-exempt obligations;

(III) the face amount of which does not exceed the aggregate amount of the acquired qualified tax-exempt obligations; and

(IV) the debt service schedule of which corresponds to that of the acquired qualified tax-exempt obligations.

THE PASS-THROUGH OF BANK DEDUCTIBILITY TO PARTICIPANTS IN A POOLED ISSUE

HOW THE PASS THROUGH WOULD WORK

CURRENT LAW: Banks may purchase qualified tax-exempt bonds and deduct 80 percent of the cost associated with the purchase and carry of such bonds. These bonds are sold by tax-exempt entities --the small issuers-- who expect to borrow $10 million or less in a calendar year. Small issuers, who would issue bank-qualified bonds on their own, do not receive this benefit when they participate in a pooled issuance, unless the pool authority itself expects to issue less than $10 million a year.

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The bank-qualified designation would either be retained by the small issuer or passed through to the pooling authority, but would not be available to both. If the bank qualification is used by the pooling authority, the local, small issuer, bonds purchased by the pooling authority may not at some future date be sold as bank-qualified obligations.

What follows is a technical correction to Section 265(b) Internal Revenue code of 1986. The proposed language has been carefully drafted with a view to prevent any perceived potential for abuse this proposal might raise with respect to pooled financing.

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SUMMARY

The United States Senate Finance Committee and House Committee on Ways and Means are considering comments and developing proposals on how federal tax code provisions can be simplified and made more efficient.

This proposal would amend the tax code to permit the limited pass-through of bank-qualified borrowing to small-issuer participants in a pooled issue.

The amendment would allow small issuers of bank-qualified bonds (also known as qualified tax-exempt obligations) to sell their bonds to a pooling issuer, or bond bank, which would then designate and issue an equivalent amount of pool securities as bank-qualified bonds and use the proceeds to buy the small issuers' bonds. Any small-issuer bonds purchased with the proceeds of the bank-qualified pool bonds could not subsequently be designated and sold in the marketplace as bank-qualified bonds.

This benefits both the small issuer and the U.S. Treasury. Small issuers participating in a pooled issue achieve the lowest possible interest rates on their bonds from the pass-through of the bank qualification, and achieve the lowest possible issuance and administrative costs resulting from economies of participating in the pool. Fewer dollars spent on cost of issuance and interest payments means fewer bonds issued and lower annual debt service costs.

For the U.S. Treasury, fewer tax-exempt bonds would mean a decrease in the supply of tax-exempt investments and a lower interest rate on such investments.

STATEMENT OF THE PUBLIC SECURITIES ASSOCIATION

The Public Securities Association (PSA) is pleased to comment on three of the bills that the Subcommittee is examining in today's hearing, S. 913, S. 150 and S. 90. Each bill merits serious consideration by the Subcommittee. Specific comments on each proposal follow.

PSA is the international trade organization of banks, securities firms and related firms that underwrite and deal in state and local government securities, U.S. Government and agency securities, mortgage-related securities and money-market instruments. PSA's members account for approximately 95 percent of the nation's municipal securities activity.

S. 913

S. 913, introduced during the 102nd Congress by Senator Max Baucus, is designed to simplify the U.S. Tax Code as it pertains to tax-exempt municipal bonds and to provide assistance to small communities seeking to finance capital investment. One of the most important provisions of this bill would reduce borrowing costs for small bond issuers by enhancing bank demand for small issue tax-exempt securities.

Background

One of the ways in which the Tax Reform Act of 1986 (TRA) influenced municipal finance was by shifting the incentives facing potential investors in bonds. The most immediate effect of the TRA with respect to demand involved commercial banks. Prior to the TRA, commercial banks were allowed to deduct 80 percent of their interest costs associated with holding tax-exempt bonds. Accordingly, banks were active players in the bond market. By the end of 1985, banks held $231 billion worth of all municipal bonds outstanding, or 35 percent.

The TRA, however, eliminated the ability of banks to deduct interest costs associated with carrying tax-exempt securities for all but a small class of municipal bonds. Congress took this action to ensure that commercial banks could not eliminate their income tax liability. PSA does not quarrel with the underlying premise of this policy goal. Rather, we are concerned about the impact that loss of bank deductibility has had on the composition of demand for municipal bonds, and by extension, what these demand changes portend for the future cost of borrowing for state and local issuers.

Current Status

As a result of the changes in the 1986 Act, banks have steadily reduced their holdings of bonds. As of the end of 1990, banks held just $117 billion worth of bonds, amounting to a reduction of $114 billion since 1985. Consequently, commercial banks (as a group) no longer support the bond market, but weaken it, since by selling bonds they add more supply to the market. In fact, banks undoubtedly would be selling at a greater rate but for the fact that their holdings in 1986 were grandfathered from the loss of bank deductibility.

Although it is difficult to quantify precisely, the loss of bank demand has certainly kept municipal yields higher than they otherwise have been. One can get an idea of the importance of bank demand by examining the one sector of bonds that banks are allowed to purchase with deductibility. In 1986, Congress decided to support the market for bonds issued by small cities and towns by allowing banks to deduct 80 percent of the cost of carrying public purpose (non-private activity) bonds issued by communities that issue $10 million or less in such bonds annually. Congressional policy goals have been served well by this provision. Although disinvesting in the municipal market as a whole, banks have remained active in the market for bonds issued by small communities (so-called "bank qualified" bonds).

Communities that qualify as issuers of bank-qualified bonds enjoy a yield advantage over similar communities that do not qualify. This advantage varies widely depending on market forces, but is currently somewhere in the neighborhood of 15 to 25 basis points (0.15 to 0.25 percentage points) and has been as high as 35 basis points in 1990. In other words, small issuers are able are able to finance their public needs more economically because the "bank-qualified" provision stimulates bank investment. In 1989, approximately $11.5 billion in bank-qualified securities were issued, resulting in an interest cost savings of between $173 million and $228 million for those issuers over the lives of their issues. Raising the limit for bank-qualified bonds to $25 million annually, as is proposed in S. 913, would extend the interest rate benefit to a wider group of small communities and would provide current small issuers with greater latitude in planning their financing activities.

Other S. 913 Provisions

In addition to expanding the number of communities that qualify to issue bank-qualified bonds, S. 913 also contains other provisions that would assist small communities and simplify the Tax Code as it pertains to public finance. The bill would:

—Raise the annual issuance limit for exemption from arbitrage tracking and rebate regulations from $5 million to $25 million.
—Require that only 90 percent of arbitrage earnings be refunded to the Treasury.
—Make the exemption from arbitrage regulations for construction bonds spent down within two years retroactive to the effective date of the TRA.
—Repeal the five percent unrelated and disproportionate private use rule.
—Allow arbitrage rebate to correct errors in yield restriction för bond proceeds.

S. 150

S. 150, introduced by Senator Daniel Patrick Moynihan, would alter the tax treatment of bonds issued by non-profit tax-exempt institutions as defined in section 501(c)(3) of the Tax Code. The bill would expand financing options for non-profit institutions and would remove some of the restrictions imposed on these institutions by the Tax Reform Act of 1986.

Background

Before 1986, tax-exempt bonds issued for non-profit institutions were treated essentially in the same manner as bonds issued directly for state and local governments, with essentially no restrictions on volume of issuance by 501(c)(3) organizations. The Tax Reform Act of 1986, however, imposed two significant restrictions on tax-exempt securities issued on behalf of 501(c)(3) organizations. First, the Act classified 501(c)(3) bonds as private-activity bonds [1] and subjected 501(c)(3) bonds to many of the same issuance restrictions as mortgage-revenue bonds, small-issue industrial development bonds and other private-activity bonds. Second and more important, the Act placed a limit of $150 million on the volume of tax-exempt bonds that any non-hospital 501(c)(3) organization can have outstanding at any time.

In crafting the private-activity bond restrictions in the 1986 Tax Reform Act Congress recognized the unique role of 501(c)(3) organizations that issue tax-exempt debt. The Act exempted 501(c)(3) bonds from many of the private-activity restrictions, such as annual state volume caps, the advance refunding prohibition, and limitations on the use of tax-exempt financing for the acquisition of land and existing property. However, despite the latitude that these exemptions provide for 501(c)(3) organizations, a number of institutions remain constrained by the $150 million limit. Because the limitation is not indexed for inflation, and because of the fiscal pressures being faced by many institutions of higher education, the number of organizations affected by the limit is likely to grow considerably in coming years.

Current Status

The institutions hardest hit by the $150 million restriction are private, tax-exempt colleges and universities. Today, approximately two dozen private, non-profit colleges and universities have reached their $150 million limit and are precluded from any additional tax-exempt borrowing. S. 150 would remove the $150 million issuance limitation and would otherwise treat bonds issued by 501(c)(3) organizations in the same manner as other non-private-activity tax-exempt bonds.

The $150 million limitation was imposed to prevent the excessive issuance of tax-exempt bonds by what were perceived as wealthy, well-endowed institutions that could afford to finance a portion of their capital investment at taxable interest rates. However, there is no direct correlation between an institution's level of endowment and its capital financing needs. Under current law, it is possible for a large but poorly endowed institution to reach its tax-exempt financing cap and be precluded from further issuance.

In addition, in order to take advantage of economies of scale in issuing securities, many 501(c)(3) issuers participate in pooled financings where proceeds from a single issue actually benefit a number of institutions. Because the $150 million limitation has removed some of the nation's larger educational institutions from the tax-exempt market, fewer pooled financings now take place. As a result, many smaller institutions now find it difficult—or more expensive—to access the market.

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[1] Private activity bonds are bonds where more than 10 percent of the proceeds of an issue are used by a private party and more than 10 percent of the debt service is secured by a private party. There are significant restrictions on the ability of states and localities to issue private-activity bonds.

By removing the $150 million limit for non-hospital 501(c)(3) institutions and otherwise treating non-profit organizations like state and local governments for the purpose of issuing tax-exempt bonds, S. 150 recognizes the important public purpose served by non-profit institutions and addresses problems created by the 1986 Tax Reform Act provisions.

S. 90

S. 90, introduced earlier this year by Senator Pete Domenici (D-NM), is a bill designed to provide financing incentives for investment in infrastructure projects that benefit the environment. The bill would, among other things, remove some of the more significant restrictions placed on tax-exempt private-activity environmental financing in the Tax Reform Act of 1991.

Background

State and local governments have traditionally played a large role in financing much of our nation's environmental infrastructure through the building of sewer and water systems, solid waste disposal systems, and other environment-related capital investment projects. Before 1986, tax law provisions allowed a considerable amount of latitude to issuers that financed environmental infrastructure with tax-exempt debt, even when the projects involved the private sector to a significant degree. Under provisions of the Tax Reform Act of 1986, however, private-activity bonds issued to finance sewage treatment systems, solid and hazardous waste disposal systems and water-furnishing facilities were, together with other private-activity bonds, subject to annual state volume cap restrictions and other issuance limitations. Certain uses for tax-exempt finance, such as private pollution-control facilities, were eliminated altogether by the Act.

Current Status

According to a report by the Advisory Commission on Intergovernmental Relations (ACIR) titled "The Volume Cap for Tax-Exempt Private-Activity Bonds: State and Focal Experience in 1989," state and local governments issued $2.4 billion of tax-exempt private activity bonds to finance environmental projects in 1989, accounting for 16 percent of all bonds issued under state volume caps. The ACIR has also found that 1989 issuance of sewage and waste disposal bonds was 49.4 percent lower than the annual average from the period 1984–1986, before the imposition of state volume caps. The 1989 volume for pollution control bonds was 93.4 percent lower than the 1984–1986 annual average. Although accurate and complete data on volume cap allocation are difficult to obtain, there is significant anecdotal evidence that environmental projects receive relatively small allocations, largely due to competition for allocation with other, more visible types of private-activity projects.

There is also evidence that demand for volume cap for environmental projects far outweighs the allocation, especially in large states like California and Florida. Moreover, environmental projects like solid waste disposal facilities often require such large allocations that a single project could exhaust a state's entire annual volume cap. In all, private-activity bonds have constrained bond-issuers in financing environmental investment, especially for projects involving the private sector.

S. 90 would create a new class of governmental tax-exempt bonds called "infrastructure bonds." Infrastructure bonds could be used to finance sewage, solid waste and hazardous waste management programs and water-furnishing facilities, regardless of the involvement of private parties. The bonds would also be used for "any other facilities whose purpose is to enable state or local governments to comply with federal environmental requirement." Infrastructure bonds would enjoy the same status as non-private-activity bonds now enjoy. Thus, infrastructure bonds would not be subject to state volume caps. In addition, the bill modifies the arbitrage rebate requirement for proceeds of tax-exempt debt to allow issuers more latitude in carrying out environmental infrastructure projects. The bill would also put environmental infrastructure facilities in a seven-year accelerated cost recovery system (ACRS) category, with a ten-year class life for the purpose of the alternative depreciation system.

By expanding the use of tax-exempt bond financing for private-activity environmental infrastructure projects, S. 90 recognizes that such services as providing drinking water, processing waste water and disposing of solid waste are traditional government activities, regardless of who owns the facilities that provide the services. The bill would provide meaningful and effective assistance to states and localities in providing these traditional government services. By using tax-exempt bonds as an incentive mechanism, the bill would provide latitude and flexibility to state and local governments in defining local or regional environmental problems and

providing solutions in partnership with the private sector. PSA supports the concept behind S. 90 and urges the consideration of responsible measures to assist states and localities in carrying out their responsibilities of providing environmental services.

[COMMENTS ON S. 267—BARING STATE SOURCE TAX]

STATEMENT OF THE AIR LINE PILOTS ASSOCIATION

The Air Line Pilots Association is proud to give its strong support to S. 267, on behalf of all our active and retired members. ALPA represents 43,000 pilots at 44 airlines.

The Association believes that some states are running afoul of individual rights, in their overzealous efforts to eliminate the red ink from their budgets. In desperation these states have resorted to taxing their old and defenseless *former residents*. Easy targets for taxation, these are law-abiding people who *previously* lived, worked and paid taxes within one state's borders but who have chosen, for whatever reason, to retire outside them.

This practice is, in the purest sense, taxation without representation, and the Association strongly supports S. 267 as a necessary means to stopping it.

State taxes create state revenue. State revenue is then allocated to provide state services to state residents. This process is all determined by elected state officials. However, a non-resident does not enjoy the benefits of this allocation process, nor can he influence the process. He is not represented. There is no one, over whom his vote has control, that he can turn to. He has no vote.

While the states have, and should have, significant powers under our nation's system of federalism, these powers must be curtailed in areas of overriding national concern. Since aviation is one of these areas, we fully appreciate the need for federal controls.

We believe state taxation of retired former residents is another such area. Congress has an overriding interest in protecting the free movement of its citizens from one state to another. This includes the right of citizens of one state to be free of governmental intrusion by a state of former residence via remote taxation.

The authority of Congress to enact this legislation is clear. It has limited the states' taxing authority on several occasions. One example involves pilots and flight attendants whose jobs may require them to occupy airspace over several states. An amendment to the Federal Aviation Act prohibits a state from taxing them on this basis alone. Another example involves military personnel who are assigned to duty in a state which is not their state of domicile. The Soliders' and Sailors' Relief Act provides that their military pay cannot be taxed by the non-domicile state. And, of course, federal law prohibits any state (such as Maryland or Virginia) from taxing the income of Members of Congress who maintain an abode in such state for purposes of fulfilling their duties in Washington.

The case of retirees who move to another state is no less compelling. It should be obvious that retirees have the unfettered right to break their ties to a state in which they formerly resided. But they never can break those ties when they are subjected to sources taxes on their retirement income. In conclusion, the Association firmly supports this bill, designed to safeguard retirees from such abuse.

June 6, 1991

WAYNE HOSIER/ED MIHALSKI,
C/O Senate Finance Committee,
Washington, DC.

SUBJECT: Senate Hearing on Pension Tax (Source Tax)

A recent column in the Washington Post dated June 6 1991, alerted readers to the impending Senate hearing on a bill to bar a state from taxing people who move to another state.

I support a Senate Committee bar which disallows any taxing authority from requiring the payment of taxes from a former citizen of the taxing authority which might be based on the former residency status, i.e. Source tax.

To permit such taxation is in reality "taxation without representation," a tenant that is one of the cornerstones of our Revolution and Constitution. To allow such an inequitable violation of the basic Bill of Rights guaranteed by our Constitution is unthinkable. It is perfectly understandable that from a political point of view, state politicians believe they will have the best of both worlds; a revenue raising vehicle without fear of reprisal from the voters, since those taxed have no voting rights in the former state. Clearly it is taxation without representation.

Personally I would take the position one step further, such that those senior citizens whose soul source of income is a retirement pension should be relieved of all state and federal income taxes. After laboring many years and supporting the federal and local governments via income taxes, they have "paid their fair share" and should be able to enjoy their "golden years" without being encumbered with tax bites out of their fixed incomes.

I urge the committee members to submit, and the Senate to enact, a taxing law which, at least, bars any state from taxing a former residents retirement income, for any reason or under any circumstances.

RAYMOND A. ALLEN.

4423 RIDGELINE CIR
TAMPA, FL. 33624
JUNE 10, 1991

DEAR SIRS,

I AM APPALED ABOUT the "SOURCE TAX". I THINK IT DISGUSTING. PEOPLE PAY TAXES WHERE THEY LIVE TO SUPPORT THEIR COMMUNITY AND STATE, IF THEY MOVE AWAY - THEY WILL HAVE TO PAY TAXES WHERE THEY LIVE AND MAYBE WORK (AND SOME OF THESE PEOPLE MIGHT NEED TO WORK TO SUPPLEMENT THEIR PENSION'S TO PAY FOR GROCERIES OR MEDICAL CARE).

I'M ALL FOR PAYING A FAIR SHARE FOR ONE'S LIVING/COMFORT, BUT I DEFINITELY DO NOT BELIEVE IN PAYING A STATE TAX WHERE ONE DOES NOT LIVE/RESIDE.

SINCERELY

Lucille Allain

American Foreign Service Association,
Washington, DC, June 5, 1991.

Hon. David L. Boren, *Chairman,*
Subcommittee on Taxation,
Committee on Finance,
205 Senate Dirksen Office Building,
Washington, DC.

Dear Senator Boren: We wish to record our support for S. 267, "a bill to prohibit a state from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that state" on which you have scheduled a hearing before your Subcommittee on June 12, 1991.

Our Association represents the interests of the Foreign Service of the United States. As you know, during their careers, Foreign Service personnel are assigned abroad for extended periods of time. While residing overseas, they may designate a certain State as a "legal," or "home leave," residence. In most instances, however, this represents a residence in name only since they rarely have occasion to benefit from any State services. Naturally, they are obliged to pay whatever taxes are due from them while claiming a State as their legal residence.

We understand that certain States are asserting their authority to levy a "source tax" on the annuities or pensions of retired persons now living elsewhere, but who maintained a legal residence during their working years in a "source tax" State. Apparently the rationale is that if an individual's retirement income was earned during years of residence in a "source tax" State—even though the source of their income was outside of that State—that State has the right to collect an income tax on that person's retirement income, irrespective of his/her present State of residence.

This practice inflicts an injustice on those Foreign Service retirees who, during their years of employment, may have maintained a legal residence in a "source tax" State but who realized no income originating from within that State. Moreover, equity suggests that all retired taxpayers (including those retired from the Foreign Service) should pay a State income tax on their retirement income only to the State in which they actually reside, where they receive benefits and services, and have the right to vote and petition their representatives.

Accordingly, we urge that your Committee support the passage of S. 267 by the Senate, thereby taking action to rectify the injustice implicit in a "source tax" State imposing an income tax on the retirement income of persons not resident of that State.

We would appreciate this letter being incorporated as a part of the record of your Subcommittee's hearings on S. 267.

Sincerely yours,

Theodore S. Wilkinson, *President.*

3171 Brillden Court
San Diego, CA 92117
18 June 1991

Messrs. Wayne Hosier & Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D. C. 20510

Dear Messrs. Hosier & Mihalski:

All About the Writers: Paula Anselmo and James Boyle have shared the purchase of a residence in San Diego, CA. They are both employed as Department of the Navy civil service employees. They both pay state income, sales and real estate taxes and automobile registration fees. They vacation within and without the state of California. They are honest, voting patriots who love each other and their state and country. They also adamantly and passionately oppose the source tax in any form for any state in the Union. Although any "right" thinking non-lawyer would intuitively agree with the "wrongness" of this idiotic and zealous misuse of unfettered tax powers, Paula and Jim will try to present their common logic against this aggressive and oppressive tax concept.

Common Reasoning: We will present our arguments against the "source tax" in a series of paragraphs that categorize our simple views against this awful concept. Much of our representations will be presented as questions that we would like the tax collecting zealots to answer. Questions posed to encourage discussion, provoke thought and illicit response.

Argument #1 - Why State Tax? We believe it is to develop and maintain systems such as roads, parks, legal, regulatory, licensing and legislative. There are probably others, but the common thread of these services is that they are internal to the state and are provided to the permanent or visiting public of that state. Neither does the state export services nor do they import tax moneys. States seem to recognize the reasonability of free trade zones, and customs holding areas for the sake of not applying taxes until merchandise is inventoried and/or sold within the state. The states withhold applying sales taxes, auto registration fees and income taxes until a sale is made, or the owner of an auto chooses to use it on the highway or until income is paid. Clearly these practices describe a system that collects on services rendered for a described period of use. In summary, the state taxes are applied internally for internal service systems.

Argument #2 - Why Taxation with Representation? As we pay California taxes, as residents, we may vote for our state and federal representatives. We then have some control over the direction of state development through our representatives. One person, one vote. We can only be a permanent resident of one state. Neither does another state try to collect income tax from us nor do they allow us to vote in their state. As we use other state's highways or services, we are taxed as they dictate through gasoline taxes, or park fees, etc., but since we do not direct their state's development through their political representatives, we likewise are not taxed as residents.

Argument #3 - Why State Sovereignty? Why does the power of the Federal Government cross state lines? Because state's powers don't. Although states cooperate with each other for mutual benefit, they jealously guard their sovereignty right to rule within their borders in a way to meet the welfare and purpose of the state and its citizenry. God only knows why any state would accept the notion that a new resident's

income tax liability should be retained by the losing state. Oregon is one of those states that send ex-California residents income taxes back to California. I can see no benefit nor gain for Oregon.

Summary: The power of the Federal Government was meant to be the connective tissue that holds the Union together. If ever there was a reason for federal intervention, the source tax is that reason. It is the essence of Orwellian government gone mad. This is the ultimate government power trip over the founding fathers intent to provide freedom to the people and a government of, by and for the people. The source tax provides no service, no representation and invades the sovereignty of sister states. It is unjust and unnecessary. For all those who freely choose to leave one state for another, they are replaced with those who come to purchase their place in the "sun." Thus, a new resident picks up the tax burden left behind. Alternatively if no one replaces those who leave, it is an obvious sign the state has lost the confidence of a free people and its collapse is justified. Paula and I are nearing retirement and are losing confidence in what used to be a great state. In our 20 or so years in California, our taxes and fees have skyrocketed while we've experienced a loss of the freedom of movement on our highways, freedom of use of our waters, freedom to breathe clean air, effectiveness of our judiciary and legislature. Our strongest vote isn't our political vote any longer, it's our economic vote that would allow us to say "enough" by leaving these poor public services and placing our tax money in another state that is affordable and effective. The freedom we need is the best exercise of Adam Smith's "velvet glove" of economics. If the government can't get the message politically let us maintain the right to economically withdraw. We the people are burdened enough without being chased down by mad dog tax collectors. We fervently hope our plea is answered with corrective legislation.

We would also hope the Federal Government learns the lesson of the economic vise its citizenry are being squeezed into by all government. Spend one time looking at the Macro-economics of approximately 30% federal income tax, 5% state income tax, 7% state sales tax, 1% real estate tax on the appraised value of a home we can no longer afford to buy and which is appraised at four times our combined income or about 4% against income, a water and sewer bill that has increased by 400% due to our Mayor O'Connor's lousy management that caused us to miss federal funding for a new sewage treatment plant because she was too busy getting her face in the paper. The tax bill alone represents about 47% of our income and we haven't yet even paid the food, lodging, insurance, auto license fees, transportation to work, repairs on home and cars that just allows us to get to and from work so we can continue to keep paying 47% to taxes. Spendable income? What's your definition? My definition is that it doesn't exist. And then when we plan for our "golden" years, we find the long arm of an over zealous and overweight government try to rob our only real freedom. Maybe Canada isn't such a bad idea.

Very respectfully,

James A. Boyle — JAMES A. BOYLE

Paula M. Anselmo — PAULA M. ANSELMO

239 Linger Lane
Sun City Center, Fl.
June 8, 1991

U.S. Senate Finance Committee
Washington, D.C. 20510

Att: Mr. Wayne Hosier
Mr. Ed Mihalski

Gentlemen:

We were formerly residents of the State of New York and moved to Florida when we retired not only for the climate but also for thelower taxes.

In today's environment all of the states are having budget problems including states that at the present time are free of state taxes.

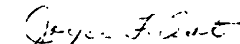
We are opposed to source taxes and feel since we paid Federal and State taxes for most of our life time, it would be an injustice to require us to start paying taxes to our state of origin.

Our greatest objection isif our retirement state, Florida, which is already discussing a state tax,decides to establish one, we would be taxed by both states.

Please consider this possibility as it apparently will become fact in the not too distant future.

Sincerely,

John E. Ast


Joyce F. Ast

jea/ja

P.O. Box 4279
Kailua-Kona, HI 96745

June 17, 1991

Committee on Finance
United States Senate
SD-205 Dirksen Building
Washington, DC 20510

Subject: S.267, to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that State
Subcommittee Hearing Wednesday, June 12, 1991

Dear sir:

There are people in my community who, if found by the California Franchise Tax Board for non-payment of source tax over the past 20 years, will lose their homes and income to that voracious sink hole of wasted money. It's up to the California Legislature to balance its budgets, not on the back of retired people who have moved to another state. Why should non-residents bail out a state so inefficiently run by the demigogs in the California Legislature.

In Hawaii, we are already burdened by Federal, State, County, Property, and a Value-added tax, and that's at the fifth highest tax rate in the U.S.A.

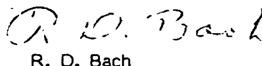
California does not allow me to vote there or receive any state benefits whatsoever. All they care about is money - any way they can steal it. If the I.R.S. used the methods used by the CAlifornia Franchise Tax Board to bludgeon a tax return from old pensioners, the U.S. Congress would fire the I.R.S. Director. See attached for proof of the above statement.

Taxation Without Representation was a centerpiece of the American Revolution, and we should never break our historic obligation to those who gave their lives for this country.

Many of us are veterans of WW-II. I also served in the Korean war, and my son spent 13 months in Vietnam. When I asked California for my second state-sponsored house and farm loan, which is my right under California law, I was turned down because I don't live in California.

Fairness should be a two-way street in this country. Today there is no tax fairness in our country as long as California source income tax is imposed on non-resident retirees. Your support of S.267 to put an end to this practice is urgently requested.

Very truly yours,



R. D. Bach

Encl.

cc: Wayne Hosier, U.S. Senate Committee on Finance
Ed Mihalski, Minority Chief of Staff, U.S. Senate Committee on Finance

California Justice?

In her Washougal, Wash. mailbox was a tax bill [from California] for $400, made out to S. Venis. Vickie Laurence wasn't worried until she noticed her own Social Security number at the bottom of the bill. . . .

Vickie suggested that the state of California locate this S. Venis, get its money from him and get his real SS number. "That's when they started telling me I should just pay the tax," says Vickie. "I said : 'No way!' "

Vickie called the Social Security Administration and it removed S. Venis' funds from Vickie's account. Vickie called the IRS. It discovered that S. Venis owed the federal government $20,000 in back taxes. Vickie explained the mistake and the IRS said she wouldn't be asked to pay the $20,000. But, said the IRS, the state of California had slapped a lien on her 1990 tax return. Vickie really should try to straighten things out with California, said the IRS.

Jim Reber, spokesman for the California tax board, says it's not California's responsibility to clear up the mistake."We're not in a position to verify some 14 million-plus Social Security numbers," says Jim.

—by Margie Boule,
The Oregonian

1 NOT MY NAME
2 NOT MY INCOME
3 MY SOCIAL SECURITY #

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
PO BOX 942867
SACRAMENTO, CA 94267-0021
TELEPHONE

916-369-0500

566249149FACT
RAYMOND B FACT
P.O. BOX 4279
KAILUA-KONA HI 96745

DATE 03/05/90
TAX YEAR 1988
NPA NO. 88-026734779
ACCT. NO. 566249149FACT
CODE 2004300

Notice of Tax Proposed to be Assessed

You did not file a 1988 California Personal Income Tax Return in response to our letter dated 12/11/89, nor did you provide information substantiating that a return is not required or proof that a return has already been filed.

You must respond to this notice within 60 days by doing one of the following:

(1) FILE A RETURN and pay any amounts due; or

(2) Explain in writing why you are not required to file a return.

IF YOU DO NOT RESPOND, YOU WILL BE REQUIRED TO PAY THE TAX, PENALTIES AND INTEREST SHOWN BELOW. Payment of this amount will not relieve you of the requirement to file a return.

INCOME DERIVED FROM INFORMATION AVAILABLE (see reverse)	$61,250.00
STANDARD DEDUCTION	1,966.00
TAXABLE INCOME	59,284.00
TAX	4,286.00
LESS TOTAL EXEMPTIONS	52.00
LESS WITHHOLDING CREDITS	0.00
TAX LIABILITY	4,234.00
PENALTY 55 PERCENT (see reverse)	2,328.70
INTEREST TO 03/05/90 (see reverse)	595.14
TOTAL TAX, PENALTY AND INTEREST	7,157.84

Additional interest is added at the rate prescribed by law from the date of this notice to the date payment is received. However, no additional interest is added if payment in full is received within 10 days from the date of this notice.

Filing a return will not relieve you of the requirement to pay penalties for failure to file upon notice and demand and for delinquent filing.

Return this copy with your return, payment or explanation.

FILING ENFORCEMENT

The Senate
The Sixteenth Legislature
of the
State of Hawaii

STATE CAPITOL
HONOLULU, HAWAII 96813

PRESIDENT
VICE PRESIDENT
MAJORITY LEADER
CHAIR, LEADERSHIP COMMITTEE ON LEGISLATIVE MANAGEMENT
MALAMA SOLOMON
MAJORITY FLOOR LEADER
MAJORITY POLICY LEADER
MAJORITY CAUCUS LEADER
MAJORITY WHIP
ANN KOBAYASHI
CHAIR, LEADERSHIP COMMITTEE ON EXECUTIVE APPOINTMENTS
MARY GEORGE
MINORITY LEADER
MINORITY FLOOR LEADER
FIRST DISTRICT
ANDREW LEVIN
SECOND DISTRICT
THIRD DISTRICT
FOURTH DISTRICT
FIFTH DISTRICT
SIXTH DISTRICT
SEVENTH DISTRICT
EIGHTH DISTRICT
NINTH DISTRICT
TENTH DISTRICT
ELEVENTH DISTRICT
TWELFTH DISTRICT
THIRTEENTH DISTRICT
FOURTEENTH DISTRICT
FIFTEENTH DISTRICT
SIXTEENTH DISTRICT
SEVENTEENTH DISTRICT
EIGHTEENTH DISTRICT
NINETEENTH DISTRICT
TWENTIETH DISTRICT
TWENTY FIRST DISTRICT
TWENTY SECOND DISTRICT
TWENTY THIRD DISTRICT
TWENTY FOURTH DISTRICT
TWENTY FIFTH DISTRICT
CHIEF CLERK

June 7, 1991

The Honorable Lloyd Bentsen
Chairman
Senate Finance Committee
205 Dirkson Building
Washington, D.C. 20510

Dear Chairman Bentsen:

It is my understanding that the Senate Finance Committee is considering S.267, dealing with the State's power to tax the retirement income of non-residents.

Although I am a State legislator, I do not believe that a state should have the power to impose an income tax on the pension or retirement income of individuals who are no longer a resident or domiciliary of that state. While individual states might attempt to protect their residents by prohibiting such taxation, the better way to deal with this issue is through Federal legislation. Therefore, I urge you to support S.267.

Very truly yours,

ANDREW LEVIN
Senator, First District

AL:CSY

cc: R. D. Bach

NORTHROP

Northrop Corporation
1840 Century Park East
Los Angeles, California 90067-2199
Telephone 213 553-6262

October 16, 1990

Mr. Ray Bach
73-1133 Ka'iminani Drive
Kailua-Kona, Hawaii 96745

Dear Mr. Bach:

Please accept our apology for the lengthy delay in responding to your inquiry.

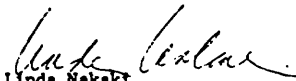
The Northrop Retirement Plan (the "Plan") is a non-contributory plan where employee contributions are neither required or permitted. Your participation in the Plan began on your first day of hire and was a condition of your employment.

Your retirement benefit was based on your age at retirement, your years of service and your salary as specified in the Plan document in effect at the time of your termination. When you retired, you elected an option which is payable for your lifetime. Therefore, no further benefits will be paid upon your passing.

Your questions regarding your taxes and the notice from the Franchise Tax Board should be referred to your tax advisor as we are unable to help you with these matters.

Please call me at (213) 201-3442 if you have any other questions.

Sincerely,



Linda Nakaki
Manager
Retirement Administration

Ms. Dora Baray
4812 Darby
Tampa FL 33603-2604
American Diabetes Association

June 18, 1991

Wayne Hosier
Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, DC 20510

Tentlemen:

I am writing in hope that you may be instrumental in helping to eliminate the current policy by some states of levying State Income Source Taxes.

I worked for 33 1/2 years in Fresno County, California when I retired in 1981. I feel that as long as I lived in the State of California, I had the obligation to pay State Personal Income Tax since I was using the services the State had to offer, such as roads, police, etc. etc. However, having moved away from the State I feel I should no longer have to pay the source tax since I am not eligible to participate in any of the state services.

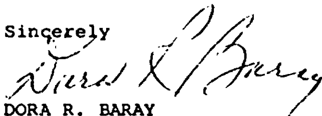
I live in Florida now where there is serious consideration being given to start a State Income Tax movement. Does that mean that I will have to be paying two State Income Taxes for the privilege of still breathing? I pay taxes here in Florida as a resident in a number of ways, property, sales, all kinds of taxes, but I feel that I must pay the taxes if I am to live here. There are no free lunches.

I do feel the source tax is unfair to retirees. This was not known by me at the time I retired, thus my original estimate of what my County pension was going to be was out of kilter as I had not anticipated paying State Income tax out of my pension. I moved to Florida to take care of my elderly parents who had lived in Florida all their lives. My take-home pay is definitely not what I had anticipated it would be when I made the move.

Please give this matter your perusal. Certainly, there must be other ways for those States to raise tax money than to tax out-of-state retirees. There are people who come in and go out of the State, working short periods of time in transitory jobs, who never even file in California, let alone pay State Income Tax.

Thank you very much for listening. Please give this matter your consideration.

Sincerely



DORA R. BARAY

To: Mr.Wayne Hosier and Mr. Ed Mihalski, U.S. Senate
Finance Committee, Washington, D.C. 20510

Sirs

I would like to make a statement in opposition to state pension tax or source taxes.
Having come to California several years ago I am now at retirement age. I have grave concern of state collection source tax. I have an elderly mother living back in my home state that I may have to go back to take care of to keep her off government pay rolls.

I feel it is very unfair an unconstitutional that I go back to take care of her and still have to pay California tax. I have and always will continue to pay taxes, but I want to pay in a state where I might live.

Your support in this area of referral of this state law is greatly appreciated

Flavis E. Borron

c/o U.S. Senate Finance Committee
Washington, DC 20510
June 12, 1991

Albert J Boudreau
26743 Mondon Hill Rd.
Brooksville, FL 34601

Dear Sirs

Please vote no that would allow States to tax persons retired, but living in another state.

Yours truly

Albert J Boudreau

June 24 1991

Dear Sirs:
In regards to the bill on "source_tax" JUST SAY NO .
I started with Pan AM in Miami Fla. in 1955. was moved to San Francisco in 1976 and retired 1985 and returned to Florida. Icertainly dont need any more taxes to reduce my small pension. Any thing you can do will be greatly appreciated.

Thanking you in advance
David L.Bowen
6935 Deer Sprs Rd
Keystone Hts. Fla.
32656

6604 Hiddenite Ct.
Alexandria, VA 22310
6 June 1991

Wayne Hosier and Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, DC 20510

Dear Sirs

It is interesting that states are trying to tax the retirement pay of former residents that have moved to other states. Maybe they got the idea from the U. S. Government that requires by law that the state where a military employee came from is the state where he pays taxes. This in place of paying taxes in the state where he currently lives, is employed, and uses the public amenities.

The Soldier's and Sailor's Relief Act that directs this tax anomaly is one of the largest discrepancies in equitable tax law imaginable. The military personnel living in Virginia are doing so at the expense of all other residents of Virginia since they pay a very small portion of the taxes the rest of us pay.

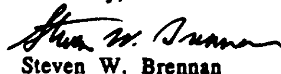
While there may have been some sympathy factor involved originally, I can assure you the military are now very well paid. The last General Accounting Office audit showed the military to be paid 27% more than Federal civilian workers and equal to the private sector.

When the Navy Commander sitting next to me makes more salary than I do, lives in a more expensive house than I do, has just as nice a car as I do, lives in the same county as I do, and drives on the same roads as I drive to work on, I would think he should pay taxes the same way I do. In actuality he pays no property tax on his car and no Virginia State Income Tax and he receives a tax-free housing allowance though he still deducts his housing interest from his Federal Income Tax. He also pays no income tax to his "State of Residence" because they only require it be paid when he actually lives there.

With the budget situation the way it is in most states it is inexcusable that everyone should not pay their fair share of the taxes. The exemption from taxes for the military, while it sounds very patriotic, does not bear scrutiny. It is time to face the fact that military people use the facilities and services of the area where they live and should thus help pay for those benefits.

Please seriously consider how we might correct this totally irresponsible tax policy for the benefit of all U. S. citizens. Let everyone, including retirees and the military, pay taxes where they are living and using the public facilities, not where they used to live and will probably never live again.

Sincerely,



Steven W. Brennan

June 19, 1991

Mr. & Mrs. Henry Brough
2227 Arch McDonald Drive
Dover, Fl 33527

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs,

On reading the recent article in the Tampa Tribune concerning the "Source Tax" which the U.S. Government would like to impose on pensioners who lived in one state, and earned a pension there; then retired to live in another state. I am furious!! Having resided in New York State for 59 years, I paid high taxes all those years compared to several other states. We had a state income tax for many years plus a federal income tax. Now in our golden years when we can use and enjoy the fruits of our hard work, the U.S. Government wants to make us pay the debts that the uncontrolled New York politicians have incurred. I cannot vote in New York state, so why should I have to pay a tax there? I must live according to my income, so let the government do likewise.

We are using part of our income to help send members of our family through college. I consider an education one of the most important achievements of ones life. Our young people in our family do not smoke, drink or use drugs (only medicinal). That, I feel is something to boast about! Young or old they know the effects of drugs and should not consume any what-so-ever. I am very much against my tax dollar going for drug addicts because in most cases it is a lost cause. We must educate our people to go to church or synagogue, and learn to obey the Ten Commandments. I may seem very hard hearted but really I am not. I advocate helping people who help themselves, or those who need a little supplement. Many don't try to help and are just looking for a free ride.

I am passing the word around and asking those people who are affected by this "Source Tax" to use their clout, if it only be a letter, and make it known to our Senators that it may mean a vote against them if they allow this to be passed. What other recourse do we have but a vote? It seems that the retiree and the Social Security recipient are always the ones to be picked on, while the wealthy are paying no income tax or very little.

Then too, I must hit on the judicial system, which in my opinion is badly in need of reform. Too much is centered on the criminal and not on the victim. The victims often don't have a second chance but the criminals have many chances such as being on death row for 10 years. Here in Florida, as it is national news, we have had seven student murders at the Gainesville State University. It is a depressing situation, having known the girl from Brandon.

Many of our people do not have health insurance because they can't afford it. Some people with disease such as asthma can't get insurance. We have a family member in this situation whom we must help with the medication. Now our Congressmen want to take away from me a sum of dollars that I need for this person. I class this as greedy and selfish.

I will be watching and studying the workings of the Congressmen on this bill. Also I will be checking each one who voted for and against the bill. That will determine my vote. I cannot stress it enough that I am definately opposed to this legislation!!

Very truly yours,

Henry Brough

Hilda Brough

June 10, 1991

TO: Wayne Hosier
Ed Mihalski

SUBJECT: STATE INCOME "SOURCE TAXES"

We would like to express strong opposition to any legislation that would permit states to levy state income taxes against former residents who have retired and moved to another state. Retirees have paid their share of local and state taxes in the states in which they worked prior to retirement and a move to another state. We regard this as a clear-cut case of DOUBLE TAXATION and question its legality.

NAME	ADDRESS
Jean Brown	3442 S. CROSSBILL LOOP INVERNESS FL 32650
Robert C Brown	3442 S CROSSBILL Loop/INVERNESS FL 32650
Nancy L. Adkins	3425 S. Crossbill Loop Inverness Fl. 32650
Everett E. Adkins	3425 S. Crossbill Loop Inverness Fl. 32650
Marjorie J. Sanders	3414 S. Crossbill Lp INVERNESS FL 32650
Norman F. Sanders	3414 S. Crossbill Lp. Inverness Fl 32650
Elizabeth Emmerman	3391 S. Stroud Terrace Inverness FL 32650
Robert O. Emmerman	3391 S Stroud Terr Inverness FL 32650

Joseph A. Buebe
5258 Queens Wood Drive
Burke, VA 22015

10 June 1991

Wayne Hosier & Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sir;

"Source Tax" (S.434 ?)

I feel that source tax by any state is "Taxation without representation", and its use now or in the future is contrary to the intent of our constitution, and should be stopped by Federal Legislation, now.

Thank you

Joseph A. Buebe

Wayne Hosier

June 10, 1991

Re: Source Tax Bill introduced by Sen. Harry Reid.

Please support the bill to outlaw source taxes.

I feel it is extremely unfair to allow a State to impose taxes on those who no longer live in that State. We do not vote in those States so there is a good example of "Taxation without representation."

Why should people be forced to pay taxes in States where they no longer receive any benefits from those taxes?

Many of us worked and payed taxes in a particular State. Now that we live in another location, we pay taxes in our new State of residence. We are still paying our fair share of government and should not be expected to pay more than that.

Let us, who are retired, enjoy the fruits of our labors. We worked very hard to have a few years in our old age to enjoy life. We have enough problems without an added and very unfair tax.

Sincerely,

Margery Burlingame

Margery Burlingame
10003 Oak Forest Drive
Riverview, FL 33569

Allen R Clark
PO Box 207
Dahlgren, VA 22448-0207

June 10, 1991

Wayne Hosier & Ed Mihalski
c/o Senate Finance Committee
Washington, D.C. 20510

For the Record:

I oppose the "SOURCE TAX", and ask my elected officials to actively support legislation to bar a state from taxing the pension benefits of people who move to another state that doesn't have an income tax.

Sincerely,

Allen R Clark

Sincerely,

Allyson E Clark

4514 Pinecrest Heights Drive
Annandale, Virginia 22003
7 June 1991

Dear Messrs. Hosier & Mihalski:

Please add my name to the list of those who oppose the source tax. That tax constitutes taxation without representation and if it can be applied to pensions, then the next step could be to tax the earnings of former residents who reside in other states.

The source tax is nothing more than a ripoff of the pensions of senior citizens who live on moderate incomes without being a financial burden on the state and federal governments.

Please enact a law that will prohibit the use of the source tax by states.

Sincerely,

Martin L. Cohen

17110 McDuff Ave.
Olney, MD 20832

June 13, 1991

Mr. Wayne Hosier and Mr. Ed Mihalski
U.S. Senate Finance Committee
Washington, DC 20510

Dear sirs:

This is a statement for the record declaring my objection to the source tax. The primary reason for this objection is that this is a clear case of "taxation without representation". The Boston Tea Party occurred to protest a similar method of taxation. Obviously this is not a problem at the Federal Level, but in order for state and local government to remain responsive to the people who elect them, taxation at the state and local government must affect only those citizens who live in the taxing area. There is precedent for this kind of action since some of the states waive taxes for active duty military whose home of record lies in their state. I feel that the bill to outlaw the source tax is most appropriate since the concept of taxing the populace only by their elected representatives forms part of the bedrock of this nation.

Thank you for your attention to this matter.

Sincerely,

John S. Cole, III

Sincerely,

Carole Cole

Colin A. Cooke.
6495-B Carlisle Place,
Ocala. Fl. 32672.

June 19th. 1991.

U.S. Senate Finanee Committee.
Washington. D.C. 20510.

Gentlemen,

Good Morning,

I protest the very idea of a Source Tax, that is, taxing me in retirement on my fixed income pension simply because my working years were in another or other States. The populous States seem to have a predilection for spending money they don't have. For those of us that spent our working years in one State only, or whose employer transferred us from State to State, are we to be taxed in retirement by five, six, seven or more States? Isn't it illegal and unconstitutional to tax a person in retirement for the benefit of a State where he or she does not live, does not use their services or facilities, and cannot vote ?

When a person retires from a high taxation State and can no longer afford to live there in retirement, and thus moves to the South East or South West, or a State without income tax, isn't that person taking a sensible path trying to ensure financial independence ?

I urge you to completely outlaw the proposed Source Tax. It borders on corruption of our protective Constitution; it is immoral. A pox on the evil minds of those that concocted it! For a time in early England homes were taxed on window area amd that drastically altered design and construction, all for the worse. Being ridiculous it was eventually repealed and perhaps the originator of the idea was even beheaded......

Please consider that I paid my State taxes for all the years that I worked, and paid my way in the County, Municipality, and District as well. I do not now have the monies I HAD then. Please tell the 'tax and spend' enthusiasts to consider the present users of all their facilities for more income, not the retirees that can no longer afford to live there, or have to move for health reasons. To even consider taxing those that no longer live or VOTE there is outrageous!

Thank you for your consideration.

Yours truly,

Colin A. Cooke.
Anne B. Cooke

10 June 1991

To: Mr. Wayne Hosier

From: Clarence R. Conrad

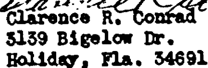
Subject: "Source Tax" On Retired Federal Employees

1. I recently read an article in the newspaper regarding the above subject. I wish to go on record as being opposed to any "source tax".

2. The tax is one more way to take money from older people who are already struggling in today's economy. It is also an attractive way for State politicians to get funds from people who do not live or vote in their State.

3. I hope the Congress will outlaw the so-called source tax. I repeat that I am opposed to the tax.

Sincerely:



Clarence R. Conrad
3139 Bigelow Dr.
Holiday, Fla. 34691

June 14, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, DC 20510

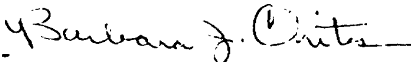
Dear Sirs:

I have worked for the Federal Government for 25 years and have paid state taxes to Virginia since age sixteen. I have lived in the Northern Virginia area all my 49 years.

I strongly object to paying taxes to a state that I will not be living in and the reason I won't be living there is because I can't afford to after I retire. It took me years to be able to afford to buy a small condo in this area, which I will be forced to sell when I retire in order not to live in proverty until I die.

I think this proposed tax is the most unfair tax I have ever heard of and I hope the state of Virginia will not activate this tax at any time in the future.

Sincerely,



Ms. Barbara J. Crites
1503 S. George Mason Drive #11
Arlington, Virginia 22204

G.P.O.
Use yellow filter highlighted copy must print

STATEMENT FOR THE RECORD

LEGISLATION S.267

June 11, 1991

Mr. Wayne Hosier
c/o U.S. Senate Finance Committee
Washington, D.C. 20515

Dear Mr. Hosier:

The purpose of this correspondence is to request support of S.267 (along with H.R. 431, 1531, and H.R. 1655) Bills that have been introduced [illegible] the U.S. Congress, to stop states from taxing non-resident pensions and annuities as a source income tax.

Taxpayers should pay taxes only to their state of residence, where they receive benefits, services and right to vote, petition, and otherwise influence representatives. As I am sure you are aware, social security benefits are exempt from this taxation as well as federal taxes, and their residence state taxes, but Federal retirees are not exempt in anyway. Taxation without Representation violates the fundamental principles on which our country was founded. I have no objection to paying my share of taxation when I have representation, but some states (particularly California) have carried this issue to the extreme and abused it. [illegible] matters worse, this non-resident source income tax is based on total income (income such as dividends earned on savings [illegible] [illegible]ence, part-time employment in another state, etc. which is ridiculous). Furthermore, this individual has little hope for justice from these taxing states outside of support from the Congress or Supreme Court to change this unjust taxation. Members of Congress have exempted themselves from these laws, and I ask tha same be considered for all retirees.

I might point out that many of these retirees have been forced to move to states that do not have income taxes in order that they may survive on limited retirement incomes with inflation and high medical costs today. Very few retirees have extra money today to throw away on such unfair taxation. Many of these retirees were required to relocate during their working years for reasons beyond their control and ended up living in one or more states to keep thier jobs and benefits such as retirement investments, etc. With the economy today, there will be many government base closings requiring such transfers to other areas and the same holds true for aerospace and otherindustries. Does this mean someday they will be required to pay several states non-resident source income tax on their pension when they relocate to a cheaper area of economy to survive on limited retirement income.

[illegible] the Senate Finance Committee Chairman [illegible] of Bill S. 267.

Sincerely,
Dorothy E. Crosby

DOROTHY E. CROSBY (Retired Civil Service Annuitant)
555 S.E. Whitmore Drive
Port St. Lucie, FL 34984
Member of NARFE and RESIST

HEARING: Wed. June 12, 1991 at 10:00 AM in Room 215, Dirksen Senate Office Bldg. by Senate Finance Subcommittee on Taxation, Senator David Boren, Chairman.

Bill #S-267: "A bill to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of the State".

TESTIMONY FAVORING PASSAGE OF S-267.

TAXES: Always a problem, a 'bitter pill to swallow'. But, "TAXATION WITHOUT REPRESENTATION", is completely unacceptable. There are a growing number of Senior Citizens being adversely affected by just such taxation on their pension income.

HOW can any State tax a person's income after they move from that State? They claim any income 'sourced' in their State is taxable, no matter where you reside. They have determined pensions to be 'source income' of their State, because it was earned while you worked in their State. Examples of 'source income' would be, income from a business, rental property, or capital gains on property in the taxing State.

CALIFORNIA does not consider investment income, earned in their State, as 'sourced' their; but as 'sourced' in the State of residency, and not taxable for a nonresident. But, investment income earned in the State of residency is used by California, when computing a nonresident's income tax. Hard to comprehend? YES!

THE LEGAL CLAIM (?) used to excuse taxing nonresident's pension income: In many cases, no income tax was ever paid on the employer's contribution to the pension fund, so this tax must be paid on any withdrawl from that fund. Then what percentage of your annuity should be taxed? Only your employer's portion at best, and that is exactly what you pay on, if you elect to collect your pension as a lump sum. That withdrawl is never taxable again; but, if you elect to take your annuity in installments, even after you leave the taxing State you are required to pay this income tax for the rest of your life. Not on that portion contributed by your employer, but on your entire pension and the tax may be computed on your entire income, regardless of it's source.

WHO HAVE YOU WORKED FOR: You may have worked in California for a company located in Illinois, your pension plan may be in New Jersey; but, California claims they have the right to tax your pension income wherever you live. You may have moved before drawing the pension, it makes no difference. How can a pension under such circumstances be considered 'source income' of California?

MOVING FROM ONE INCOME TAX STATE TO ANOTHER INCOME TAX STATE:

We are told the State of residency usually (not always) gives credit for the tax paid to the former State of residency, to avoid double taxation (for some unknown reason it is not considered double taxation to pay income tax on a sales tax, as is the case of those States having no income tax; but, do have a sales tax). There seems to be the misconception that if you move to a State that has no income tax, you do not have to pay any taxes.

PURSUING THE COLLECTION OF INCOME TAXES ON NONRESIDENTS: Individuals have been removed from a State for as long as 50 years before being approached for this tax. Persons were never told, when they retired, they would continue to be taxed on pension income no matter where they resided, and in some cases told they were not required to pay if they left the State. California is guilty of allowing persons to live outside their State for many years before attempting collection of this income tax, then they add

penalties (55%) and interest (25%). Pensions of individuals who were not taxed as residents, became taxable when they left the State, because of a change in State tax laws, after they moved. This law was put into effect without any vote of these many retirees who had left the State.

COLLECTING STATE INCOME TAX OF ONE WHO HAS NEVER LIVED IN THE STATE: Two persons worked for the same company, headquartered in California. Both would receive pensions considered as 'sourced' in California. The 'in State' employee and the 'out of State' employee both get their pension from the same fund. They both could then be taxed on their pension, except the resident retiree could receive certain tax credits not allowed the nonresident retiree.

RETIRING PERSONNEL: Seniors, forced to retire on a fixed annuity, because they are no longer fully productive in the work force. Seniors, who have planned for the day when they could enjoy amenities employment deprived them of. Seniors, encouraged by Government to save, so they would never become a financial burden on Government. So now, along with all the other increased expenses accompanying aging, a very few States can place a financial burden on retirees, which in many cases, they are unable to meet.

STATES REACTION TO NONRESIDENT TAXING OF PENSION INCOME: Because of concern for the unfair financial burden placed on 'imported' retirees, some States have enacted 'protective' laws to keep States from seizing property, in the resident State, should the abused retiree be unable to satisfy the taxing State's alleged tax obligation.

COMPLEXITIES & DIFFERENCES OF STATES TAXING PENSION INCOME: Some States exempt all income from tax, some exempt all pension income, some exempt a portion of all pensions, and some exempt all or a portion of CERTAIN pensions. S-267 would certainly simplify the tax problem for at least, the nonresident.

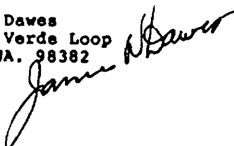
RESIDING AND HAVING WORKED IN SEVERAL STATES: Problems are faced by the retiree who has worked in more than one State. He must file income tax forms for each State that demands taxes on his pension, resulting in a tax preparation expense that exceeds the tax liability. Tax accountants must have ready access to the intricate tax laws of all fifty States, making for a greater margin of error in the tax computations of the nonresident retiree.

WE ARE LIVING IN THE UNITED STATES OF AMERICA: We are not living in Europe, Asia, South America or Africa, and while our States have a right to govern themselves to a great extent, we still have a CENTRAL Federal Governmental body to see that justice is carried out by the States.

FINANCIAL GAINS FOR INCOME TAXING STATES: Under the present practice of States taxing nonresident pension income, the problem will intensify to the point where no State will enjoy any great deal of financial gains. There will be only the added expense of collecting, printing and preparing tax forms, etc. An accounting 'nightmare', not to mention the 'friction' created by the 'tax war' between the States.

COST OF PASSING S-267: Without any cost to the Federal Government and some increase in revenue for the Internal Revenue Service, this inequity of taxing the pension income of individuals not residing or domiciled in the taxing State, can be corrected by voting into law Bill S-267.

James W. Dawes
118 Palo Verde Loop
Sequim, WA. 98382



John B. Denning
1720 Pasadena Avenue
Sebring, Florida 33870

June 21, 1991

Honorable Wayne Hosier
U.S. Senate Finance Committee
Washington, D.C. 20510

Reference: State Retiree Source Tax

Dear Senator Hoiser:

I am concerned about the legality of recently imposed retiree state source taxes by several states, regardless where the retiree resides. I am opposed to such an unfair tax, i.e., taxation without representation. I strongly recommend that your committee report include strong support for congressional action to prohibit such unfair state source taxes.

In that regard, there are many questionable administrative and legal problems related to such a state source tax. For example:

1. What constitutes state territorial rights for an employee having lived in one state and worked in another?

2. What would be the status of a Virginia or Maryland resident who worked in the Virginia-located Pentagon which has a D.C. address, and was paid from a finance office located outside of Virginia and Maryland?

3. In case such a tax was imposed, how could it be enforced on an equitable basis?

4. It must be presumed that such a state tax would provide for complete individual taxpayer rights to all of that state's resident rights, including state elections, state services, and state entitlement programs.

5. State entitlement programs for medicare/medicaid services could become a severe financial burden for any state imposing source taxes. Surely organized retiree groups would pave the way for obtaining medical assistance from that state through legal taxation rights.

It is understood that Senator Harry Reid, Democrat from Nevada, has introduced a bill that would outlaw state source taxes for retired employees. Hopefully, your committee report will support that bill to the extent possible and be submitted in time to become a factor in the evaluation and promotion of the bill for vote.

Sincerely,

John B. Denning

JBD/ehg

June 17, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, DC 20510

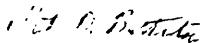
To Whom It May Concern:

The thought of paying a state tax on my retirement pension to a state in which I no longer live or vote is disgusting. The senator who introduced this bill along with every lawmaker who supports it should be removed from office.

I am originally from Ohio, retired and moved to Florida, primarily because the taxes are lower here and housing is more affordable. I worked for the Timken Company in Canton, Ohio for 34 years and retired with a small pension. I retired in 1979 and now in 1991 my pension check is exactly the same. It never went up a dime and never will. It is a struggle to cope with inflation and every day living expenses on a fixed retirement pension. We retirees are trying to live our last years in dignity, so PLEASE DON'T BURDEN US WITH MORE TAXES THAN WE ALREADY HAVE.

This additional retiree tax is repulsive to citizens like myself who worked very hard and long to make this the great nation it is.

Thank you.



Pat DiBattista
2105B Lake View Dr
Tampa, FL 33612

June 9, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o US Senate Finance Committee
Washington, DC 20510

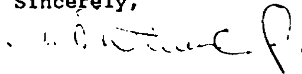
Dear Sirs:

I would like to register my strong support for the bill being introduced by Senator Harry Reid, of Nevada, regarding the source tax.

As a US Department of State employee who anticipates retiring away from the high costs of living of northern Virginia, I would find it absolutely unfair to be required to pay a portion of my pension to a state in which I did not reside. In fact, I consider the whole source tax concept to be constitutionally illegal, as I have paid state income taxes while I have been a legal resident of Virginia, even though I have served overseas with the US Foreign Service. Although the Commonwealth of Virginia does not now pursue the source tax issue, that may not always be the case.

Senator Reid's bill to make the source tax illegal is right on target, and deserves to be made into law.

Sincerely,



Leonard A. Dillard, Jr.

10801 Oldfield Drive
Reston, VA 22091

459 Sycamore Lane
Haines City, FL. 33844
June 12, 1991

Wayne Hosier & Ed Mihalski
% U.S.Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

I strongly protest the proposed "Source Tax" on my pension.

I have been retired for eight years, with a meager pension based on a much lower salary than that currently paid for the same position, and, as a widow, must cope with inflation on this fixwd income.

It is only a matter of time before the states with no income tax will be levying a state tax on its residents.

I receive no services from my former state, and feel that this proposed tax would only foster the irresponsible fiscal management and malfeasance of the legislators, and perpetuate the lack of 'ncentive to reform.

Yours truly,

Irene Dooley

June 13, 1991

Wayne Hosier
United States Senate
Committee on Finance
Washington, D.C. 20510

Dear Sir,

Subject: Statement re. S.267 Hearing, 12 Jun 91

I believe the practice of source taxes by the states, of which California is one, is completely unacceptable in our system of representative democracy. The practice runs contrary to the long-standing American notion that taxation must be accompanied by representation. This obviously is thwarted when people are forced to pay taxes to a state in which they are excluded from voting, and thus without representation.

There are many legislative leaders, both at the State and Federal level, who have committed themselves to support the abolishment of this unfair method of taxing. I applaud them for their stand in ensuring simple fairness and decency to our retired citizens, as well as all Americans who may live in more than one state during their lifetime. It is through efforts of people such as this, as well as citizen involvement, that has caused at least one state (New Jersey) to re-think the morality of their source tax law, which now has been repealed.

Sir, simply put, I joined the armed forces in 1954, and have been a Federal Employee every since. I just recently found out about source taxes. No one, especially the state of California, advised me of a lifetime tax obligation simply because my employer, the United States Air Force, sent me here to work. Now my thoughts drift to my upcoming retirement later this year, and the task of finding a tax preparer in rural Alabama who is knowledgeable of both Alabama and California's tax laws to prepare my tax returns each year. That, of course, is in addition to the pain of paying taxes to a state that I do not live in, cannot vote in, have no access to government services, and if I were to visit California, I would have to pay an out-of-state fee for the privilege of a fishing license.

Sir, I'm told the Senate and Congressional Representatives have passed a law the exempts themselves from this type of taxation while working in Washington, D.C. That is discriminatory. The remainder of Americans deserve no less from you as our elected officials. As such, I respectfully ask that S.267, and any other similar bill, be supported to eliminate taxation without representation.

Ken Durell

Ken Durell
3100 Vineyard Rd
Roseville, Ca 95678

Gertrude C. Eberly
385 W. Richards
Fallon, NV 89406
6-13-91

Wayne Hosier
U.S. Senate Committee on Finance
Washington, DC 20510
and
Ed Mihalski, Minority Chief of Staff
U.S. Senate Committee of Finance
Washington, DC 20510

Re: S-267-Hearing June 12, 10am Non-Resident Source Tax on Retirement Pensions

Enclosed please find a copy of my letter of March 29, 1988, sent to 118 U.S. Senators and Representatives which explains the circumstance under which I learned I was liable for non-resident source tax in California.

Also enclosed is an Associated Press release nationwide which further explains my circumstances.

In October 1989, the State of Nevada enacted legislation preventing other states from placing leins against personal and real properfty and levying bank accounts of Nevada residents for nonpayment of source taxes levied by other states.
In April 1990, I cancelled authorization for the California State Public Employee's Retirement System to withold source income tax contributions from my retirement pension and stopped paying $50 per month on back source tax on my retirement from California.

Lastly, enclosed is a copy of the last statement I received from the Calfornia State Franchise Tax Board dated June 11, 1991.

I urgently request the Senate Finance Committee to approve S-267 allowing it to go before the full Senate for a vote which it is hoped will be favorable.

Were I to move to another state or country; I would not have the protection of Nevada law to prevent the California State Franchise Tax Board from placing leins against property nor it's ability to levy my bank account. Therefore, I am prevented from joining my daughter and family in Japan where they will be in residence until 1994. At the age of 75, I must remain in Nevada alone with my only family being halfway around the world.

Your support of S-267 will be greatly appreciated.

Respectfully,

Gertrude C. Eberly
Gertrude C. Eberly

Gertrude C. Eberly
385 W. Richards
Fallon, NV 89406
702-423-2197

March 29, 1988

This concerns notification by the California Franchise Tax Board that I owe back California income tax, penalties and interest for 1986.

I left California in December of 1978 after retiring from the State of California after 31 years of service, June 30, 1978. I paid California State income tax for that first six months of my retirement in 1978 plus capital gains tax for the sale of my house to California State Franchise Tax Board.

December 14, 1987, I was notified by California State Franchise Tax Board I had not paid income tax for 1986. I responded promptly completing what I assumed to be the proper section of the form advising the Franchise Tax Board I had not lived in California since December 1978, and listed my California retirement income. February 24, 1988, I received from the Franchise Tax Board notice I owed $417.22 in taxes, penalties, and interest for 1986.

I lived in Idaho from December 1978 to November 1983, when I moved to Fallon, Nevada, where I have resided since. I was never apprised by the California State Retirement Board, the Franchise Tax Board nor tax preparers that I was expected to pay income taxes to California.

When I called the Franchise Tax Board, February 24, 1988, in answer to my questions, the Technician replied over and over, "you earned the money in California and you have to pay non-resident tax". (This implies that I owe 10 years of back taxes, penalties, and interest.) It appears that I will be unable to get my questions answered without going to Sacramento, further, I have no recourse beyond the Franchise Tax Board. This further illustrates my contention that this is taxation without representation, and thus unconstitutional. Had I remained in Idaho I would be paying income tax to two states and the Federal Government.

I am 71 years old and do not have the means to contest this (as a retiree and widow). Therefore, the Franchise Tax Board has license to assess whatever penalties thay choose, in this case 55% of the original assessment, plus interest.

I have recently returned from the office of a CPA. Enclosed is a copy of a similar case which was appealed and the State Board of Equalization upheld the Franchise Tax Board ruling that pension income derived from employment in California was subject to a non resident tax. (see enclosure)

Raymond F. Regan, CPA of Fallon, agrees I and others who are residents of Nevada and other states aside from California, in no way can benefit from that tax nor through such taxation are we entitled to representation.

Under the circumstances, an appeal to the Board of Equalization would be frivolous other than going through the process as a preliminary to a court action. The process would be futile unless a tax attorney would be willing to take a class action suit on a contingency basis, as most retirees do not have the means to oppose this unfair, and I believe unconstitutional taxation.

I am bringing this to your attention in hopes that Federal Legislation might be feasible to aleviate the burden on the senior population caught up in this travesty.

Based on the 1986 assessment of taxes at $261.00 p/a plus the 55% penalty, I would owe approximately $4045.50 plus accrued interest for the 10 years. I am unable to pay back taxes, penalties, and interest at this stage of my retirement years. Accordingly the CPA states the Franchise Tax Board of California can attach my retirement pay. Please note my annual gross retirement income is $13,008 with $1,415 of that going to Federal Income Tax leaving a net income of $11,593.00 or $966.00 per month to cover rent, utilities, medical, food and personal expenses.

I did not keep a copy of the initial form issued December 14, 1987, by the Franchise Tax Board, or my reply, as I was certain that I couldn't be liable for California State taxes under the circumstances.

Any help or advice will be greatly appreciated. I am appealing to you as my resources and energies are limited at this stage of my life.

Respectfully,

Gertrude C. Eberly

Gertrude C. Eberly,

CC: 16 Members Senate Subcommittee on Labor and Human Resources
19 Members Senate Special Committee on Aging
65 Members House Select Committee on Aging
15 Organizations of Advocates;
Senior Alert Process
Senator Chic Hecth of Nevada
Nevada Legal Services
Representative Barbara Vucanovich of Nevada
California Public Employees Retirement System
California Franchise Tax Board
Association of American Retired Persons
Govenor of Nevada
Govenor of California

Encl: Franchise Tax Board 5820 (7-87) pages 1 & 2
Excerpt: Guidebook to California Taxes--Appeal Decision
Franchise Tax Board Letter, February 29, 1988

GCE/pm T 3-29-88

214 Guidebook to California Taxes

● *Pension income of nonresident*

Appeal of John J. and Virginia Baustian (1979) (CCH CALIFORNIA TAX REPORTS ¶ 15-609.94) involved the opposite of the fact situation in the line of pension cases cited above; that is, the pension was based on services rendered in California and was received after the taxpayer moved to Idaho. The State Board of Equalization held that the pension did not "accrue" until after the taxpayer became a nonresident. However, the Board held that the pension was nevertheless taxable by California, because the income was attributable to a California source. (Note that in the cases cited above the source of the income is irrelevant, since a California resident is taxable on income regardless of its source.) Later decisions of the State Board of Equalization have held to the same effect.

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
PO BOX 942840
SACRAMENTO, CA 94240-0040

February 29, 1988

In reply refer to
724:ATS:042BM:ba

G G Eberly
385 W Richards
Fallon NV 89406

Account No.: 568074489eber
Tax Year: 1986

Thank you for your recent communication.

In order to determine if a pension is subject to taxation by California the following guidelines may be used:

A. If the pension is based on services performed in California, the amount received is subject to taxation by California. This applies to residents and nonresidents since they are both taxable on income from California sources.

B. If the pension is not from California sources it will only be subject to California taxation if it accrues while the taxpayer is a resident of California. (Note: If the receipt of the pension payment is subject to the survival of the recipient, it will not accrue until it is actually received.)

A special rule applies to employee pension plans when (1) the employer contributed part of the cost and (2) the individual will recover his cost (total employee contributions) within three years. Under this rule, pension payments are nontaxable until an amount equal to the employee contributions has been paid. All benefits in excess of employee cost are then fully taxable. Many Federal, State, county and local retired employees recover their cost within three years; your particular pension plan may be of this type.

All appropriate forms are being sent under separate cover.

Taxpayer Services

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
P.O BOX 942867
SACRAMENTO, CA 94267-0021
TELEPHONE

916-369-0500

568074469EBER
G C EBERLY
385 W RICHARDS
FALLON NV 89406

DATE	02/22/88
TAX YEAR	1986
NPA NO.	86-026638882
ACCT. NO.	568074489EBER
CODE	2003800

Notice of Tax Proposed to be Assessed

You did not file a 1986 California Personal Income Tax Return in response to our letter dated 12/14/87, nor did you provide information substantiating that a return is not required or proof that a return has already been filed.

You must respond to this notice within 60 days by doing one of the following:

(1) FILE A RETURN and pay any amounts due; or

(2) Explain in writing why you are not required to file a return.

IF YOU DO NOT RESPOND, YOU WILL BE REQUIRED TO PAY THE TAX, PENALTIES AND INTEREST SHOWN BELOW. Payment of this amount will not relieve you of the requirement to file a return.

INCOME DERIVED FROM INFORMATION AVAILABLE (see reverse)		$12,772.00
STANDARD DEDUCTION	INCLUDED IN TAX TABLE	0.00
TAXABLE INCOME		12,772.00
TAX		261.00
LESS TOTAL EXEMPTIONS		43.00
LESS WITHHOLDING CREDITS		0.00
TAX LIABILITY		218.00
PENALTY	55 PERCENT (see reverse)	174.03
INTEREST TO	02/22/88 (see reverse)	25.19
TOTAL TAX, PENALTY AND INTEREST		417.22

Additional interest is added at the rate prescribed by law from the date of this notice to the date payment is received. However, no additional interest is added if payment in full is received within 10 days from the date of this notice.

Filing a return will not relieve you of the requirement to pay penalties for failure to file upon notice and demand and for delinquent filing.

Return this copy with your return, payment or explanation.

FILING ENFORCEMENT

A8- -The Patriot-News, Harrisburg, Pa., Friday, August 18, 1989

Dunned:

Retiree must pay state she left in 1978

Associated Press

SACRAMENTO, Calif. — Seventy-two-year-old Gertrude Eberly had been retired for nine years, living in Nevada on a modest pension when the state of California dunned her for nearly $4,000.

Even though Eberly had moved from California in 1978, the Franchise Tax Board sent the former state worker a bill in December 1987 for back taxes, interest and penalties on her California pension for 1981-86.

After exhausting appeals to the tax board and state and federal politicians, Eberly arranged to pay. California allowed her to make $50 monthly installments to accommodate her annual pension and Social Security income of less than $13,000.

But in pursuing the money, California unwittingly fueled a growing grass-roots campaign against what Eberly and other pensioners nationwide say is unfair taxation by states.

"I was just totally overcome and so helpless," Eberly said in a telephone interview from her home in Fallon, Nev., where she moved to be near her daughter's family after retiring with 31 years service in the California Employment Development Department.

"I wrote, I think it was 120 letters to senators and representatives and advocacy agencies for the elderly. I got seven replies. In those, they said, 'Well, this is not our problem.'"

Her Nevada representatives told her that since it was a California tax, she should write to Gov. George Deukmejian. Deukmejian's office politely suggested she write her Nevada representatives.

"I had no representation. That's when I got angry and decided it was unconstitutional."

California is one of states that collect a "source tax" on pensions sent outside their borders, said Bill Hoffman, head of a group called Retirees to Eliminate State Income Source Tax, or RESIST.

The other states are Idaho, Iowa, Kansas, Maryland, New Jersey, Oregon, Utah, Vermont and Virginia, Hoffman said. North Carolina recently approved a similar tax and several other states are poised to do so, he said.

RESIST members complain they are paying taxes to states where they are no longer residents, can't vote and don't use the freeways and other tax-financed services.

"Of course the biggest objection to this tax is that it's taxation without representation," Hoffman said. "I have no control over it. They could double or triple or quadruple the tax and I couldn't do anything about it."

Hoffman, 57, a retired aerospace engineer, founded RESIST last summer after he and his wife, Joanne, moved from Torrance to Carson City, Nev., only to find they still had to pay California taxes. Nevada has no state income tax.

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
SACRAMENTO CA 942672021

NOTIFICATION OF TAX LIEN

568074489EBER0328898187000383288894

DATE: 03/28/89

568074489EBER
GERTRUDE C EBERLY

385 W RICHARDS ST
FALLON NV 89406

Tax Years: 1981-83,84,85,86,87

Balance Due: 3,832.88

RETURN this portion with your payment

KEEP this portion for your records

DATE: 03/28/89

568074489EBER
GERTRUDE C EBERLY

385 W RICHARDS ST
FALLON NV 89406

A STATE TAX LIEN HAS BEEN FILED FOR YOUR DELINQUENT CALIFORNIA PERSONAL INCOME TAXES. THE LIEN ATTACHES TO ALL REAL PROPERTY YOU OWN OR ACQUIRE IN SACRAMENTO COUNTY.

A lien is a matter of public record which may seriously impair your credit until released.

Recording fees required by law are included under collection costs in the summary below. A release of lien will be forwarded to the COUNTY RECORDER upon full payment of the balance due. Failure to pay the balance due immediately may result in additional collection actions without further notice.

SUMMARY OF BALANCE DUE

TAX YEAR	TAX	PENALTY	INTEREST	COLLECTION COSTS	PAYMENTS	TOTAL
1987	239.00	112.46	35.59	10.00	0.00	397.05
1986	319.00	174.03	97.43		0.00	590.46
1985	245.00	100.00	111.81		0.00	456.81
1984	279.00	100.00	181.89		0.00	560.89
1983	230.00	100.00	218.19		0.00	548.19
1982	212.00	100.00	272.39		0.00	584.39
1981	222.00	100.00	373.09		0.00	695.09

PAY THIS AMOUNT * [illegible]

* Additional penalty and/or interest accrues at the rate prescribed by law from the date of this notice to the date payment is received. However, no additional interest will accrue if payment in full is received within 10 days from the date of this notice.

Enforcement Bureau
Telephone Number (916) 369-0500 568074489EBER 032889 8187 000383288

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 102d CONGRESS, FIRST SESSION

Vol. 137 WASHINGTON, THURSDAY, JANUARY 24, 1991 No. 16

Senate

Mr. BRYAN. Mr. President. I rise today in support of legislation just introduced by the senior Senator from Nevada which will prohibit the collection of State source income taxes from pensioners.

As we all know, many individuals choose to retire to States other than that where they spent their working life. There are many reasons for such moves, and I think we all agree that retirees have the right to live wherever they choose.

As Senator REID has just described, however, many American retirees are not allowed to break their ties to their former State. While these individuals are not allowed to vote in their former State or enjoy any of the services their former State may offer, they are forced to pay State income taxes on their retirement income to their former State.

While this problem is especially acute for retirees who move to States like Nevada, which collects no State income tax, the injustice of this "taxation without representation" should offend and outrage us all.

No one likes to pay taxes, but most of us understand the benefit we receive from the taxes we pay. What benefit do my constituents receive from the taxes they pay to California?

All of us will someday be dependent on pension income. Why should our investment in pensions tie us forever to any particular State? Many pensioners move to Nevada with no regard, or awareness, of the tax status of their pensions. One of the most distressing stories I have heard regarding these taxes has been reported in a Nevada newspaper. Quoting from the Las Vegas Review Journal:

Perhaps the saddest case is that of 72 year old Gertrude Eberly of Fallon [Nevada]. Nine years after moving to Nevada, she suddenly was hit with a bill for $4,000 in delinquent California income taxes. Unable to pay it all out of her $13,000 annual income, Eberly agreed to pay $50 a month to California. If she lives long enough, she might be able to pay off the debt.

How can we justify such misuse of the power of taxation? These pensioners do not vote in California, and thus have no vehicle to convey their opposition to the tax. Nevada's elected officials have no power over California taxes. The only solution is Federal legislation to ban State source taxes; therefore, the need for our legislation.

Source taxation of pension income is especially troubling since, for the most part, pensions cannot be removed from the offending State. Pensioners may transfer all their other assets to whatever State they desire, but their pensions are held hostage by the State in which they were earned.

Considering the longer lives we all hope to enjoy, this fact becomes especially shocking; 85-year-old retirees are no longer uncommon: such an individual may well be paying taxes to a State from which he has derived no benefit for the past 20 years.

I have spent most of my 26 years of public service at the State level. I value the right of States to govern themselves as much as any other Member of this distinguished body. Nevertheless, these rights stop at the State border.

Senator REID and I introduced this legislation during the 101st Congress, and concluded the session with 15 cosponsors. Similar legislation introduced in the House of Representatives attracted 94 cosponsors.

I urge my colleagues in the Senate to cosponsor this legislation and to help us put an end to this unfair practice.

1

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
PO BOX 2952
SACRAMENTO, CA 95812-2952

CALIFORNIA STATE INCOME TAX DUE NOTICE OF COLLECTION REFERRAL

568074489EBER052791789000065435699

DATE: 05/27/91

568074489EBER
GERTRUDE C EBERLY

385 N RICHARDS ST
FALLON NV 89406

Tax Years: 1978,81,82,83,84-9

Balance Due: 6,543.56

FTB 4982-M (REV 7-87)

RETURN this portion with your payment

KEEP this portion for your records

Final Date for Payment: 06/11/91

Legal action is pending on your unpaid account. Failure to pay the balance in full or contact this office within fifteen (15) days from the date of this notice will result in the referral of your account to a Collection Agency in your state for collection purposes. You are liable for any additional cost incurred by this Department as a result of the referral. (Revenue and Taxation Code Section 18837(a) and 26254(a).)

Payments and/or adjustments to your account through 05/10/91 are shown below. If you paid the full amount after 05/10/91, please disregard this notice. If you paid the full amount on or before 05/10/91 contact us immediately with proof of payment, such as the number we stamped on your cancelled check.

SUMMARY OF BALANCE DUE

TAX YEAR	TAX	PENALTY	INTEREST	LIEN FEE	PAYMENTS AND ADJUSTMENTS	TOTAL
1978	1,062.00	241.25	1,677.85	7.00	721.00	2,267.10
1981	222.00	100.00	463.33		450.00	335.33
1982	212.00	100.00	433.20			745.20
1983	230.00	100.00	369.04			699.04
1984	279.00	100.00	336.25			715.25
1985	245.00	100.00	237.51			582.51
1986	319.00	100.00	228.11			647.11
1987	239.00	100.00	138.62	10.00		487.62
1990	126.00	3.60	.80		66.00	64.40

PAY THIS AMOUNT* 6,543.56

* Additional penalty and/or interest accrues at the rate prescribed by law from the date of this notice to the date payment is received. However, no additional interest will accrue if payment in full is received within 10 days from the date of this notice.

Please make your check or money order payable to the FRANCHISE TAX BOARD. Write account number 568074489 on your check to assure proper credit to your account.

STATE OF CALIFORNIA TELEPHONE: (916) 369-5005
FRANCHISE TAX BOARD, PO Box 2952, Sacramento, CA 95812-2952 568074489EBER 052791 7890 000654356

FTB 4982 M (REV 7-87)

1843 Wolf Laurel Drive
Sun City Center, FL 33573
June 8, 1991

Wayne Hosier and Ed Mihalski
U.S. Senate Finance Committee
Washington, D.C. 20510

Gentlemen:

This is written to inform you of our opposition to the so-called "Source tax". We strongly support passage of the bill introduced by Senator Harry Reid of Nevada which would outlaw the Source tax.

As we understand it, the theory of such a tax is that some or all of the benefits earned during the time that a person was a resident of a state can by taxed by that state even after the person becomes a resident of another state.

The assumptions inherent in such a theory are ridiculous. While a resident of any particular state, a citizen is subject to all legal requirements for payment of taxes imposed by that state. While a resident of that state, the citizen can vote on what taxes should be imposed and how such taxes should be used by that state. However, when the citizen leaves that state and becomes a resident of another state, he or she can no longer express opinions by vote as to either imposition of taxes or disposition of revenues. Taxation by the former state would certainly be "taxation without representation", and this nation came into existence largely because of opposition to that idea.

The main purpose of taxes is to pay for services provided its citizens by a governmental entity. When a citizen leaves a state and establishes residence in another state, that citizen is legally required to pay taxes in the new state of residence. When the services of a former state of residence are no longer available to a citizen, he or she certainly should not be taxed to pay for such services.

Sincerely,

Paul B. Edwards

Sarah B. Edwards

Note: Five copies are enclosed for your convenience.

Frank Franz
108 E. 5050 South
Ogden, UT 84405
18 Jun 91

Commitee on Finance:

My law professor at Wayne State University, the late Alfred Kelly, lectured our class quite extensively on the importance of Article IV of the United States Constitution. This is the article that guarantees "Full faith and credit" among the several states. Dr. Kelly kept telling us of its various aspects, such as: we don't need passports and visas to travel between states; tariffs on goods passing between states are not permitted; citizens of any state are entitled to the rights and immunities of those of any other state; etc. Dr. Kelly called it the glue that made us one nation.

And now we see an attack on that glue. The source tax, a tax levied on citizens of one state by another, effectively violates this idea of equal protection under the law. Now a citizen can be taxed without any representation or recourse. Now an American can be penalized for traveling across state lines for the purpose of selecting a residence. Perhaps he doesn't need a visa but tribute must be paid to this, now foreign, state which renders him no service except to forcibly collect that tribute

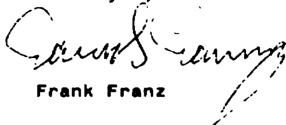
The purpose of Article IV was to make us one nation, able to defend ourselves against aggression, to work out our economic destiny without the waste of interstate tariffs, without bloody internecine warfare being a way of life, as it was in the fragmented suzerains of Europe. It was the European example that led to these concepts. Concepts that have worked well over our his-

tory. That have avoided, except for one sad episode, the spectacle of states trying to gain hegemony over one another, never agreeing on anything, vulnerable to external conquest, unable to reach the full potential that a united states, a unified nation, has been able to reach.

It is ironic that after 200 or so years, Europe has realized the error of its ways, probably from our example. They are forming an economic community the has the potential for far exceeding our own. It is ironic because at the very time they are putting our example into practice, a handful of self-serving state legislatures are trying to set a precedent in the opposite direction. If we had a Chief Justice John Marshall around, I'm certain he would oppose such a state of affairs. Unfortunately, he's been dead since 1835; it's up to you folks now.

This could be a turning point in our society. Will the states with their insatiable greed for more revenues be allowed to erode our nation, or will the principle of national supremacy be reasserted? This could be an historic turning point; I hope it doesn't fall through the crack. Please approve, and report favorably on S. 267.

Thank you,



Frank Franz

6-8-91

Mr Thomas W - Gallagher
249 - Milwaukee ave
Dunedin Fla - 34698

Dear Sir

The reason I am writing To you, is two Inform you, That I am opposed to the so called "Source Tax" & I am damned well Ticked off of This, so called Idea, I am informing my friend's, neighbor's of this situation, who may not be aware of This, The article was in my daily paper fortunately, I am retired on a fixed Income, from another previous state also, and I have payed my share of Taxes, during my working year's, and earned my pension, as ever retiree as done, according to the newspaper article, There are 10 state's That don't have any Income Taxe's, plus 417000 federal retiree's, These people should be made to pay state Taxe's, Plus it's Time our Big Corporation, haven't been paying Taxe's for year's, and it's Time To nail Them also,

31

They are no better than the average worker, If it wasn't for the worker's [illegible], They wouldn't be able corporation's [illegible] This a good thought. But Florida Senator's [illegible] in taxes, [illegible] wouldn't have to [illegible] a tax on the deceased, or those who don't vote, [illegible] is an [illegible]. Next Wednesday The Senate Finance sub committee, will be having a hearing, on this nuisance "Source Tax idea" It doesn't give the public, To much Time, To you people and Congress, To oppose This idea, That's about all I can Think of saying, at The Present Time.

Sincerely yours,
Thomas W. Gallagher

BEST AVAILABLE COPY

June 17, 1991

Subcommittee on Taxation
Committee on Finance
United States Senate
Washington, D. C. 20510

Subject: Hearing on June 12, 1991, of Bill S.267, to prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that State.

Gentlemen:

We would like to take this opportunity to impress on the members of the Senate Finance Committee the importance of supporting Bill S.267 and releasing it for a vote of the entire Congress.

As a veteran of the U. S. Navy and being retired from the Federal Civil Service System, we find a problem with the Source Tax curtailing another of our freedoms - that of being able to relocate to whatever area of the country in which we choose to live without paying a penalty for this freedom.

There are no services available and no vote is allowed when a move is made; any State collecting source taxes is certainly practicing taxation without representation. The Revolution was fought over this very issue.

A person who has worked in more than one State could be responsible for income taxes to each of those States. More than forty States have laws taxing source income; no doubt they are waiting for Congress to ignore the issue to begin collecting the taxes, just as California is doing at the present time. The richest people in America in the near future will be tax accountants because no average American citizen could possibly work his or her way through such a maze of paper-work. This extra burden would cut further into retirement incomes.

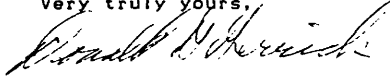
We understand that members of Congress are exempt from these taxes, why not all of us? In following the activities of Representatives and Senators at both the State and Federal levels of government, we believe our freedoms are being taken away by the people we elect to protect us.

The excuse for collecting source taxes concerns those pension plans on which state income taxes are deferred until such time as retirement is realized. Those of us who were employed by the Federal Government paid taxes on our gross salary, not on an adjusted amount after the pension deductions were made. Why are federal retirees being included in the "deferred tax category"?

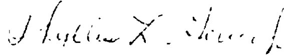
We have no objections to paying our fair share of taxes in the area where we live because each city, county, and state must have income to provide the necessary services for its citizens.

Individual citizens cannot possibly afford to pursue this matter through the court system. The power of governments with their attorneys and accountants would destroy any "grass-roots" effort to obtain a fair hearing in any court in the country. We are depending on the members of Congress for support with this measure.

Very truly yours,



Donald G. Gerrick



Phyllis L. Gerrick
225 South Rancho Street
Ridgecrest, California 93555

Gordon L. Goewey
404 Blackhawk Cr.
Sun City Center, FL 33573

June 11, 1991

Wayne Hosier and Ed Mihalski
U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

You are currently involved in a debate concerning whether to bar states from imposing so-called "source"taxes. As a 67 year old former resident of New Jersey now residing in Florida I wish to comment.

One of the problems of retirees who are mainly dependent upon pensions and social security is that their total income is relatively fixed and does not grow to meet rising costs. Countless millions of retirees can look forward only to increasing poverty as they become older. However, that is not the point of this letter.

Numerous no-income tax states (Florida is the one with which I am most familiar) have developed ways to compensate for the lack of an income tax. Florida has dramatically increased various existing fees and has established many new ones. The State has budgetary needs quite similar to the states with income taxes and has chosen to develop other sources of income rather than passing an income tax. The result is that citizens are being "taxed" as surely as if there were an income tax.

As a Florida retiree I am paying the equivalent of an income tax. If New Jersey were to also impose a "source" tax on me I would end up with double taxation. This is grossly unfair to all citizens in this category and is particularly unfair to those on fixed incomes.

I appeal to your sense of fairness. Please make every effort to prevent states from extracting a "pound of flesh" from former residents.

Respectfully yours,

Gordon Goewey

cc: Mickie Valente
"The Bottom Line" columnist

WAYNE HOSIER
ED MIHALSKI
C/O U.S. SENATE FINANCE COMMITTEE
WASHINGTON, DC 20510

I WOULD LIKE TO SUBMIT A STATEMENT FOR THE RECORD CONCERNING THE PENSION TAX.

I LIVE IN VIRGINIA AND PLAN ON MOVING TO FLORIDA WHEN I RETIRE. I FEEL THAT I HAVE PAID MY TAXES TO VIRGINIA ON INCOME EARNED WHILE I LIVED IN THIS STATE, AND WHEN I LEAVE I WANT TO TERMINATE ALL RELATIONSHIPS WITH THIS STATE. IT WOULD BE GROSSLY UNFAIR THAT I COULD BE TAXED BY VIRGINIA WHEN I LEAVE SINCE I WILL NOT BE RECEIVING ANY BENEFITS FROM VIRGINIA (IF, I FACT I RECEIVED ANY WHILE I LIVED HERE). I WILL NOT BE VOTING IN VIRGINIA, I WILL NOT EVEN BE PRIVILEGED TO BE TAXED ON MY PERSONAL PROPERTY, AND THEN BE CHARGED ANOTHER FEE TO BUY A STICKER FOR MY CAR SHOWING THAT I HAVE PAID MY TAX.

I HAVE ALSO PAID VIRGINIA TAXES ON A MILITARY RETIREMENT WHICH WAS EARNED TOTALLY OUTSIDE THE STATE, EVEN THOUGH VIRGINIA WAS EXEMPTING THEIR OWN STATE/COUNTY RETIREES FROM PAYING TAXES ON THEIR PENSIONS. YOU ARE PROBABLY AWARE THAT THIS IS STILL IN LITIGATION.

I WILL BE PAYING MORE THAN ENOUGH TAXES WHEN I RETIRE TO FLORIDA, WHICH PROBABLY HAS THE HIGHEST HIDDEN TAXES, SALES TAXES, ETC., THAN ANY OTHER STATE IN THE UNION (UNLESS IT'S MASSACHUSETTS!)

THE THEORY THAT ANYTHING EARNED IN A SOURCE TAX STATE SHOULD BE TAXABLE WHEN A PENSIONER LEAVES THE STATE IS LUDICROUS...

SINCERELY,

JOHN T. GILBERT
9854 FAIRFAX SQUARE #212
FAIRFAX, VA 22031

10 JUNE 1991

1087 Alcala Drive,
St. Augustine, Fl. 32086
June 11, 1991

Messrs. Wayne Hosier and Ed. Mihalski,
c/o Senate Finance Committee,
Washington, D. C. 20510

Gentlemen:

Refernce is had to the matter of a source-tax on my civil service pension. I lived in Maryland from March 1931 to Sept. 1987 at which time I moved to Florida and purchased a home at the above address.

I retired from N.A.S. Patuxent River, Md. after 43 years of service on June 1973, and during that time paid taxes to Maryland for income and real estate. Since Sept. 1987, I am a registered voter and propertyowner in Florida and to require me to pay a income tax to Maryland does not seem right.

Respectfully,

Francis E. Gorely.

538 Country Meadows Blvd.
Plant City, FL 33565
June 12, 1991

Messrs. Wayne Hosier and
Ed Mihalski
C/O U.S. Senate Finance Committee
Washington, D.C., 20510

Gentlemen:

I retired from Inland Steel Industries, located in East Chicago, Indiana, in 1985, after thirty (30) years of employment. I paid federal and local taxes all my employment years.

After retirement, my wife and I moved to Florida to get away from the cold, snow-shoveling, etc., and we feel it would be very unfair to pay a Source Tax on my pension.

I have no COLA on my pension, so after five (5) years of retirement, my wife is working full-time at the Plant City Chamber of Commerce and I am working part-time at a manufacturing plant of mobile homes, just to make ends meet.

We feel it would be very unfair to tax my pension a SECOND TIME, as I feel sure, many retirees in the same predicament would agree. Retirees will rise up in anger if this happens.

Please do what you can for those of us who were forced into early retirement and have some pension benefits. It will be six and one-half (6½) years till Social Security benefits will be received and the Cost of Living rises every year.

Sincerely,

Gerald W. Gott

Frank C. Galford
4554 Targee Avenue
North Port, Florida 34287

Wayne Hosier & Ed Mihalski
U.S. Senate Finance Committee
Washington, D.C. 20510

18 June 1991

Gentlemen:

Is there no end to the ways and means that politicians want to tax - tax - tax???

Please enact the bill to abolish the source tax. Surely individual rights carry more weight then States rights.

Thank you for your efforts and time.

Sincerely,

Frank C. Galford

Copy To:

Senator Graham
Senator Reid
Mickie Valente, The Tampa Tribune

Wayne Hosier and Ed Mihalaski
U.S. Senate Finance Committee
Washington, D.C. 20510

June 22, 1991

Dear Sirs,

This is in regard to your planned hearings on outlawing state source taxes on retirees.

I will begin by quoting from an article in the July, 1991 issue of MONEY magazine that describes the current mess:

> "Uncle Sam and the states treat an IRA rollover as a nontaxable event," says financial planner Paul Westbrook of Watchung, N.J. So far, so good. Trouble starts, however, if the state you have departed goes after the money once you begin withdrawing it from your rollover IRA. California, for instance, taxes the pensions and IRAs of former residents because they earned the money there. Outrageously, it also grabs for a piece of the pensions that new residents have earned in other states, presumably just because it's there - although the newcomers get credit for taxes paid to their former state of residence. Despite numerous challenges, California's Board of Equalization has upheld both practices. The state aggressively tracks down miscreants with the help of its powerful computers and income data from the Internal Revenue Service. Penalties can range to as much as 55% of the tax owed, and liens may be slapped on houses and bank accounts - unless the tax dodgers live in Nevada, Washington or Florida, which have banned the practice.
>
> Though less grabby, six other states exercise similar long arms: Iowa, Missesota, New York, Ohio, Oregon and Vermont. Five more have such laws on the books but don't currently enforce them: Arizona, Georgia, Kentucky, Louisiana and North Dakota.

In my case I worked and lived in California and retired to Oregon three years ago. Since moving I have had to file a non-resident California return and claim a credit on my Oregon return for pension taxes. I'm not out any money but preparing an additional tax form is a hassle. I also greatly resent being taxed by a state that provides me no services and where I have no vote.

The MONEY magazine article also states that California taxes rollover IRAs of former residents. I was not aware of that and would have ended up owing California back taxes and penalties when I begin drawing on my IRA account. I'll bet there are few ex-California residents who are aware of this tax requirement.

The states that impose these source tax laws, Oregon included, argue that the person earned their pension while residing there. I would guess that the amount of money my employer (Pacific Telesis) put into the pension fund, and treated as a business expense for tax purposes, was miniscule when compared to the earnings on those funds through investment. I don't believe source tax states have a legitimate claim to those pension funds.

I hope the effort of your subcommittee and the Congress are successful in banning these provincial state taxing policies. We have to look to you because the State Boards of Equalization and Legislatures have shown they are out to make a buck regardless of any fairness considerations.

Best wishes,

Thomas J. Green

Thomas J. Green
230 Coachman Drive
Jacksonville, OR 97530

cc: Mark Hatfield, U.S. Senator
Bob Packwood, U.S. Senator
Bob Smith, U.S. Representative
Ron Grensky, Oregon Senator
Eldon Johnson, Oregon House

6/11/91

Mr Wayne Horner & Ed Mettelstein(?)
Enclosed is a copy of the letters sent to my Senators & Representatives and I ask you to question also.

I ask that you support legislation to bar states from imposing "source taxes" on retirees with pensions earned in one state, now living in a different state.

This is unfair and unconstitutional, taxation without representation, I also contend no state should be able to collect taxes where the taxpayer will recéive no benefit of services or in any way have a say in the disposition of said tax monies. The services received from any of these "states" were bought and paid for by taxes at the time they were received and therefore these states are due nothing.

In closing let me leave you with this one glaring fact, with the present taxes and fees, and increasing budgets, increasing size of government (fed.,state,& local), lack of discipline of members of government (all of above), there has developed a growing lack of confidence in a majority of voter representation. Please consider this and please pass it on to your colleagues.

Yours truly,

[signature]

Earl D. Hart Sr.

EARL D. HART
7665 ALTURAS LOOP RD
BARTOW, FL 33830

SUBCOMMITTEE HEARING JUNE, 12, 1991

S.267

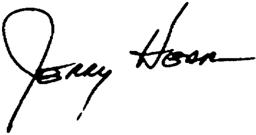
WAYNE HOSIER
UNITED STATES SENATE
COMMITTEE ON FINANCE
WASHINGTON, D.C.
20510

SIR:

I AM WRITING TO SHOW MY SUPPORT FOR TAX BILL S.267. IT IS MY BELIEF THAT THE "SOURCE TAX" IMPOSED BY STATES ON PENSIONS EARNED IN THAT STATE IN PRIOR YEARS IS NOT ONLY UNFAIR TO THE PERSON RECEIVING THE PENSION, BUT IS ALSO UNFAIR TO THE STATE IN WHICH THE RETIRED PERSON LIVES. THE STATE OF DOMOCILE HAS THE EXPENDITURE FOR SERVICES WHILE THE OTHER STATE HAS THE BENEFIT OF REVENUE.

I WOULD URGE SUPPORT OF THIS BILL.

JERRY R. HEARN
P.O. 8476
TRUCKEE, CA
95737



940 Highland Ave.
Gettysburg, PA. 17325
June 10, 1991.

Messrs. Hosier & Mihalski:
U. S. Senate Finance Committee
Washington, D.C. 20510

Re: Source Tax by States

Gentlemen:

Please register my support for any legislation that would ban or outlaw any form of source tax by States.

While employed in Maryland, I entered into a 457 deferred income plan offered as part of the pension benefits by my employer. Upon retirement in 1988 I decided to move to my home state of Pennsylvania

Recently I inquired about commencing payments from the plan and was informed that the State of Maryland would tax the income under their source tax law. I feel that this is not correct or fair for several reasons.

1. Never was I informed that this was one of the provisions of the plan.

2. The administrator of the plan is in Texas and I doubt that any of the earnings came from Maryland investments.

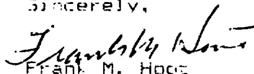
3. I have not been a resident of Maryland for the last three years and a good part of the earnings in the plan have been made during this time.

4. While living in Maryland I paid all my taxes and I feel we should have the freedom to move without being beholden to a prior state.

I trust the Senate Finance Committee would go forth with a recommendation of a complete ban on source taxes.

Thank you.

Sincerely,



Frank M. Hoot

3 Village Center Drive, SMW
Homosassa, Florida 32646
June 19, 1991

Honorable Wayne Hosier andEd Mihalski
C/o U. S. Senate Finance Committee
Washington, D. C. 20510

Gentlemen:

My wife, Bobbie, and I are absolutely opposed to the "source tax" under consideration by your committee; and I'm certain it is opposed by every retiree, military or otherwise, who falls within the so-called middle income bracket.

The reason should be obvious; we have borne the brunt of income tax for years - and still do- so any encroachment into the dollars we now manage to hold on to will be the final straw in most cases.

We see the waste of luxury spending by US, state, county and city government officials and the exorbitant luxuries enjoyed by private industries and wonder why this money isn't tapped for the good of all. How can their luxuriant executive expenses be justified and our meager fruits of long hard work not be.

Please leave what little, in comparison to non-retirees, money we get alone.

Yours truly,

James L. Honea Jr.
James L. Honea, Jr.
US Army Retired
Also US Civil Svc

Info: Senators Graham and Mack
of Florida

3008 Sunrise Drive
Sebring, Florida, 33872
June 10, 1991

Mr. Wayne Hosier
U. S. Senate Finance Committee
Washington, D. C., 20510

Dear Mr. Hosier:

Please put forth your efforts to bar states from imposing the so-called "source" taxes.

We paid for our state services while we lived there and we don't want to pay taxes for services to the state when we're not living there and having no say in how the tax monies are spent.

During the 35 years of one's working life you plan for retirement, in particular, the most important financial portion. It is unfortunate that after retirement, something such as this, is always nipping away at your carefully made plans. Unforseen taxation of social security, increased health care premiums, and the proposed "source"tax could easily put retirees at a poverty level or at least make life less than pleasant.

So please, fight to protect us and ban the "source" tax. Thank you.

Sincerely,

Guy P. Horton

Frances S. Horton

7625 Glenville Court
Springfield, Virginia 22153

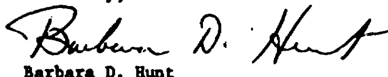
11 June 1991

Wayne Hosier/Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

I strongly urge you to vote against any and all source taxes either in existence now or those which may be proposed in the future. How can any state have taxation without representation?

Sincerely,



Barbara D. Hunt

STATEMENT OF THE IOWA TAXPAYERS ASSOCIATION AND THE IOWA ASSOCIATION OF BUSINESS AND INDUSTRY

RETIREMENT: WHOSE GOLDEN YEARS?

The issue of state taxation of pension distributions to nonresident taxpayers is one which can only be resolved by Congressional action which would prohibit the states from taxing such income.

Much like the controversy involving state taxation of corporate income (which ended in the enactment by Congress of Public Law 86-272), the growing attempts by states to extend their taxing jurisdictions outside their boundaries will create extremely complicated and costly tax policy and administration problems.

For example, most taxpayers are cash basis taxpayers. A cash basis taxpayer is one who pays tax only when income is received. Thus, pensions earned as an employee, but paid commencing at retirement are normally not taxed until payments are received. Then they are taxed by the state where the retiree lives. Currently eight states reverse this traditional approach and claim the right to tax pension distributions of nonresident retirees which accrued in part in those states while the retiree lived in that state.

In contrast to this, an accrual basis taxpayer pays tax on income when the right to receive such income occurs regardless of when it is paid. These eight states require nonresident retirees who participate in pensions (and are normally considered to be cash basis taxpayers) to be treated as accrual basis taxpayers for retirement income purposes.

Any tax structure, be it state, local or federal is designed to pay the cost of providing services by that level of government. The taxes raised during a certain tax year generally designed to pay the costs of those services rendered during that period, not some time in the future. As needs and costs change, tax structures change. Assume two individuals who worked side by side in a first state, e.g., Iowa, for their entire career, earned the same amounts of income, and in all other respects are identical. They would pay virtually the same amount of taxes during their career and both would pay for the same services from the same levels of government. When they retire, one remains in Iowa where the retirement was earned, and the other moves to Georgia. The one who remains continues to receive services and continues to pay Iowa taxes. The other pays taxes in Georgia, but also would be expected to continue to pay income tax in Iowa.

The first state cannot justify an attempt to tax pension income of the retiree who no longer lives there. There is no constitutional basis for such an attempt because a nonresident is receiving no benefit from the taxing state. The nonresident paid the same share of taxes for benefits received while living in the original state as did everyone else who lived in the state during that period.

Difficult questions of tax equity arise in the attempt to tax nonresident pension benefits. In the first place it is impossible for a state to apply this tax uniformly and equitably. The retiree who is receiving monthly checks from a defined benefit plan is easily found and the amount of income received easily ascertained. The retiree who rolls over a deferred compensation distribution to an out of state fiduciary, on the other hand, is not easily found will not likely be taxed by the state of origin.

Another major problem with state taxation of nonresident pension benefits is that it inherently creates the potential for serious jurisdictional disputes and ultimately the prospect of double taxation. In the case of a retiree who worked in several states which tax nonresident pension income, each state would claim original jurisdiction to tax a portion of the income. Even if all these states granted a credit for taxes paid to another state the taxpayer would have a near impossible task in determining how to allocate each credit against all the others.

To make matters even worse, not all states grant a credit for taxes paid to another state on nonresident pension income. Georgia for example, refuses to allow a credit for taxes paid by one of it residents for Iowa income tax claimed by Iowa. Thus some retirees face double taxation of retirement income.

The administrative burdens created by taxing nonresident pension benefits are horrendous. It must be assume that the only way states will come close to being effective in collecting these taxes is through withholding, and therein lies the major problem. As is demonstrated in later examples, it is not equitable to apportion taxes based simply on the number of years someone worked in a given state. In many cases an individual could have worked in a state for several years without being vested in a pension, thereby earning no benefits. Others may have worked in several states for several different employers, rolling over pension accumulations as they move from one job to another.

Taking this argument to another level, we believe the taxation of nonresident pensions is in violation of the U.S. Constitution on several grounds. First is the Privileges and Immunities Clause which prohibits states from discriminating against out of state individuals. There is a sharp distinction between a nonresident who is earning income from business, trade or occupation and is subject to tax at the time of the business activity, as opposed to a nonresident who no longer has a connection with the state, except to have earned a pension while living there. The former is receiving benefits and services for taxes paid; the later is receiving nothing.

Second is the Commerce Clause and the Due Process Clause. The most often cited case under the Commerce Clause and Due Process Clause is *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977). On at least three points the taxation of nonresident pensions fail to meet the test that was prescribed and Complete Auto. First, it discriminates against interstate commerce, as evidenced by the fact that nonresidents can be subject to double taxation. Second, it cannot meet the test of fair apportionment. Third, it is not fairly related to the services provided by the state.

We also believe the taxation of nonresident retirement income also violates the Employees Retirement Income Security Act of 1976 ("ERISA"). ERISA was enacted to make the regulation of pension plans a federal concern and to insure uniformity so that states could not adopt policies which adversely impact the benefits earned by retirees. The attempt by states to tax nonresident pension benefits is a policy which has adverse impact on the benefits earned by retirees. Any pension tax policy which creates numerous additional expenses and puts taxpayers in jeopardy of double taxation is contrary to ERISA.

A former resident of the State of Iowa, for instance, must determine the portion of a retirement plan distribution attributable to the distribution over total income earned which relates to the distribution. The result of allocating the distribution to the state in this manner runs the risk of subjecting a nonresident taxpayer to Iowa tax which does not actually reflect the amount distributed to the taxpayer as a result of the taxpayers services within the state. Outlined below are three examples demonstrating this result.

EXAMPLE 1

Assume that a taxpayer lives and works in Iowa for ten years and earns $575,000 during such ten year period. The employer contributes $'75,000 to the taxpayerls retirement plan over the ten year period. Assume that over the next five year period, the taxpayer works and lives in Florida and earns $450,000 and that the employer contributes $55,000 to the taxpayer's retirement plan. After five years of employment in Florida, the taxpayer retires. Under the allocation method formula discussed above, 56.10% (575,000/1,025,000) of the total distribution or $72,930 (.561O x 130,000) will be allocable to and subject to tax in Iowa when the taxpayer actually received from the Iowa employer $75,000.

EXAMPLE 2

Assume the same facts as before, except that the employer contributed $55,000 to the retirement plan while the employee lives and works in Iowa and the employer contributed $75,000 to the retirement plan while the employee lived and worked in Florida. Under this scenario the nonresident taxpayer will be subject to Iowa tax on $72,930 of the total distribution when the nonresident taxpayer only received $55,000 from the Iowa employer. Since Florida does not have a state income tax, this result could be quite devastating to the nonresident taxpayer. These examples demonstrate, however, that the method chosen by Iowa to tax nonresident taxpayers does not truly reflect the nonresident's earnings within the state.

The above example can get even more complicated if income was deferred through a retirement plan in a state which, like Iowa, seeks to tax deferred income upon receipt of the income. In addition, if the taxpayer moved to several different states, rather than just two, the burden can become even more egregious and the method of calculating the Iowa tax can become even more difficult.

EXAMPLE 3

Worker A and worker B earned $250,000 over the course of five years in Iowa. Both worker A and worker B had $25,000 contributed toward their retirement plan. Worker B moved to Florida and worked an additional five years in Florida earning an additional $250,000. Worker B's employer contributed $50,000 to B's retirement plan. In the first year of their retirement, both workers elect to take a lump sum

distribution from their retirement plans. Worker A will be taxed on the full $25,000 that his employer contributed from Iowa sources. Worker B will be taxed on the portion of "occupation" carried on within Iowa. That is, the portion of his $75,000 lump sum distribution that is attributable to an Iowa occupation. Since 50% ($250,000/$500,000) was earned in Iowa, it stands to reason that $37,500 (.50 x $75,000) of the distribution will be allocated and taxed to Iowa when only $25,000 was actually contributed from Iowa sources. Two workers, A and B, similarly situated, are taxed differently.

The "source approach" to defining a state's right to tax income has the potential of extending even further beyond the limits of rational tax policy. For example, how will this doctrine apply to other tax deferrals such as the capital gain on the sale of a primary residence?

It seems that this is no different than deferred compensation from a pension program. An individual can move from state to state, buying and selling homes, rolling over the capital gain until finally he or she retires and takes the one time capital gain exclusion. At that point is every state where that person lived going to lay claim to a portion of the remaining gain?

As we said before, this issue is appropriate for congressional action. While states should be free to fashion their own tax scheme, there are times when federal intervention is necessary.

There is precedent for congressional action of Public Law 86-272, which sets the statutory limits on state's rights to tax corporations whose activities within the state consist of mere solicitation of sales. Federal intervention is needed to prevent states from depriving nonresident retirees of their "gold" in their golden years.

RICHARD W. PHILLIPS, *President, Iowa Taxpayers Association.*
MARK DOUGLAS, *President, Iowa Association of Business and Industry.*

John J. Isely
9117 Canberley Dr., Tampa, Fl., 33647

June 11, 1991

Wayne Hosier and
Ed Mihalski
c/o U.S. Senate Finance Committee,
Washington, D.C., 20510

Subj: Source Taxes

Gentlemen:

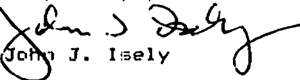
This is to inform you that I am in opposition to the imposition of source taxes on pensions by states where one was previously employed.

State taxes are for the support of the government of the individual state to supply services necessary for its citizens. A source tax scheme is just another way for state government to avoid the issue of higher taxes with their constituents who can vote in their state!

If the citizens of the source state want services, they should pay their own way by taxing themselves. The northern state's elected representatives naturally would favor this kind of 'cop out" tax. The taxpayers they are going after have moved south and won't be able to vote against them in the next election. This is their way of trying to ride the train without paying the freight!

I am a registered voter who votes in every state and national election - and a retiree. I have been employed in four states and can just imagine the bureaucratic taxation nightmare this kind of scheme would produce.

Very truly yours,



John J. Isely

BEST AVAILABLE COPY

H. C. 60, Box 160
Pineville, MO 64856-9602
June 22, 1991

Mr. Wayne Moshier
U. S. Senate
Committee on Finance
Washington, D. C., 20510

Dear Mr. Moshier:

Re: Senate Bill No. 267

Presently many retirees are being forced to pay income taxes to a state, in which they do notreside. The non-resident state provides no benefits, whatsoever to the retirees. They are not permitted to vote or have a voice in that state's governmental operations. This is not only DOUBLE TAXATION, but TAXATION WITHOUT REPRESENTATION, which was the cause of the Revolutionary War, thus resulting in the independence of the United States of America. Isn't this regression, back to the pre-Revolutionary War days? I sincerely hope not.

The enactment of S. B. 267 into a law, would prevent this type of unfair practice of a state upon the retirees that chose to live in another state upon retirement. The extra burden of double taxes, will result in many retirees having to forego some ot the necessities of life; i. e., food, clothing, adequate medical and hospitalization and many other items that are far from items of luxury. Why should retirees be forced to pay double, just because they moved from one state to another? Is the UNited States becoming less than a free country in this century, when many of our young men and women gave so much, many their lives so that we could live in a FREE COUNTRY?

My wife and I moved to Missouri, so that we could assist in the care of our elderly Mothers, and now we are faced with double taxation/taxation without representation. Is this fair? Retirees move for a variety of reasons, i. e., to be nearer family members, to assist aging parents, health conditions, or just to live in a s maller, slower-paced community. Taxation without representation was not the intent of the framers of our constitution, so why is Congress permitting some s tates to put the entire U. S. A. on the road of regression?

If such practice is not eliminated, it could result in every state taxing a particular segment of retirees of another state. Such a practice could result in a state collecting taxes from residents of 10, 20, even 40 or more states. The passage of S. B. 267 or other appropriate legislation would eliminate such complicated confusion and restore fairness to all retirees.

Your assistance in the passage of appropriate legislation, to prevent TAXATION WITHOUT REPRESENTATION will be appreciated.

Sincerely,

Lenno C. Johnston
President, McDonald County Retired Teachers

June 7, 1991

Wayne Hosier & Ed Mihalski
c/o U.S. Senate Finance Committee
Washington DC 20510

Dear Sirs:

I am in favor of legislation to bar a state from taxing the pension benefits of people who move to another that doesn't have an income tax.

The so-called "source" tax is unfair to senior citizens. Please relay this message to the U.S. Senate Finance Committee.

Thank you,

4179 Tampico Trail
Spring Hill, Florida 34607
June 7, 1991

U.S. Senate Finance Committee
Washington, D.C. 20510

Mr. Hosier & Mr. Mihalski,

After reading an article in the Tampa Tribune, June 7, 1991, about source tax, I wish to express my thoughts on the matter.

I am totally against this tax for it will take a person on a fixed income and make him a person on a lower fixed income, and at 72 years of age, with no way to increase my income.

Sincerely Yours,

Howard J. Joy

June 6, 1991

U.S. Senate Finance Committee
Washington, D.C. 20510

Sirs:

This letter is to support federal legislation which will bar any state from imposing a "source" tax on the pension benefits of people who move to another state that doesn't have an income tax. I object to paying taxes to a state I no longer live in, expecially since I did pay my share of taxes when I was a resident in that state. Such a tax is taxation without representation.

It is my hope that the legislators will support such legislation as it is fair and moral in protecting the income of all pensioners.

Sincerely,

Vincent F. Kashuda
1734 Farmington Ct.
Crofton, MD 21114

2319 Lancaster Drive
Sun City Center, FL. 33573
June 12, 1991

Wayne Hosier & Ed Mihalski
% U.S.Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

I strongly protest the proposed "source tax" on my pension.

I have been retired for twenty-one years, with a pension based on a much lower salary than that currently paid for the same position, and must cope with inflation on this fixed income.

It is only a matter of time before the states with no income tax will be levying a state tax on its residents.

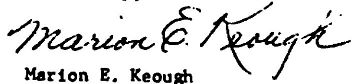
We receive no services from our former state, and feel that this proposed tax would only foster the irresponsible fiscal management and malfeasance of the legislators, and perpetuate the lack of incentive to reform.

May I add that I deplore your reqūisite that these protests be typewritten, knowing full well that most people do not have access to a typewriter.

Yours truly,

Edmund F. Keough

Yours truly,



Marion E. Keough

1801 Crystal Drive, #1004
Arlington, VA 22202
June 12, 1991

Senators Wayne Hosier and
Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Subject: Pension Tax

Dear Sirs:

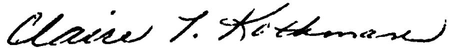
As a federal worker who currently needs to be living in California for personal reasons, but who can't because of the potentially taxing (pun) situation, I would like to go on record to ask you to vote this down.

My argument is that a majority of the federal workers transfer several times throughout their career. It would be terribly unfair for one state to put a source tax on all of your retirement. I am 57 years old, with considerable health problems, and need to move closer to my adult children who are in California; however, any retirement pension I receive will be slim, and a state tax could certainly hurt me.

California, and some of the other states with excessive state taxes, should realize that the "new generation" is not closing their eyes to this excessive taxation. The network news coverage has recently highlighted how firms/business are moving away from the costly California environment.

Thank you for your time.

Sincerely,



CLAIRE T. KOTHMAN

Debra Kwiatkowski
81 Riverside Dr.
Indian Head, MD 20640

June 10, 1991

Wayne Hosier & Ed Mihalski
c/o Senate Finance Committee
Washington, D.C. 20510

For the Record:

I oppose the "SOURCE TAX", and ask my elected officials to actively support legislation to bar a state from taxing the pension benefits of people who move to another state that doesn't have an income tax.

Sincerely,

Debra Kwiatkowski

June 8, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
U.S. Senate Finance Committee
Washington, D.C., 20510

Dear Sirs:

It has come to my attention through an article in the June 6, 1991 Tampa Tribune that the Senate Finance committee is holding hearings on whether to bar states from imposing "source" taxes on retirement pensions. I would like to be counted among the many who I'm sure have gone on record as being opposed to any legislation that would permit states to collect a "source" tax. I shall be contacting my Senator and representatives concerning my opposition to this "source" tax issue.

Sincerely,

Joanne Latham

8759 Barcin Circle
Riverview, FL 33569

6079 E. Rush Street
Inverness, Florida 32652
June 8, 1991

Wayne Hosier & Ed Mihalski
% U.S. Senate Finance Committee
Washington, D.C. 20510

Gentlemen;

When we lived and worked in the state in which we were employed, we paid taxes on our income to support the services received from that state. The income put back into the company retirement fund was also taxed.

We no longer live in that state but you are goigg to tax us again on money that was taxed once, in order to support services no longer received.

If you think the reaction to catastrophic insurance was something, just wait until the groundswell on this one gets up steam.

Sincerely,

Robert P. Layton

12305 Rambling Lane
Bowie, Maryland 20715-3211
June 10, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
Senate Finance Committee
Washington, D.C. 20510

Gentlemen;

I would like to comment on pending legislation to outlaw the so-called 'source tax':

First, as a member of NARFE I fully support their lobbying efforts in opposing this odious taxation-without-representation!

Second, I have recently completed a real estate course required by the State of Maryland for obtaining a license to act as a real estate agent. Although I have no plans to enter that profession I took the course in preparation for selling my own home, and I learned a lot from it. (No pun intended, i.e., 'lot'!)

One of the things I learned is that the tax on real estate is figured by multiplying the tax rate by the assessed value of the property. In most, if not all, states the assessment of value for tax purposes is a responsibility of the state government, while the tax rate is set by the county, school district or other local jurisdiction.

We were taught that the assessment process was gradually taken over by state governments after experience with county or local governments that deliberately 'underassessed' property in their jurisdictions in order to 'poor mouth' the state into giving them a disproportionate share of state revenues. The state assessment process is intended to assure greater equity state-wide.

I believe the same rationale ought to be applied nationally, by the Federal government--that state efforts to receive a disproportionate share of taxation by means of devices such as the 'source tax' should be regulated and proscribed as necessary, to insure as much national fairness as possible!

Respectfully,

Roger D. Leonard

Mrs. Martha A. Logan
P.O. Box 3082
Apollo Beach, Fl. 33572

June 17, 1991

Mr. Wayne Hosier
U. S. Senate Finance committee
Washington, D. C. 20510

Dear Mr. Hosier;

It has come to my atteniton that your committee is investigating the use of a "source tax" to be imposed by states on pensions earned in that state.

First, let me state that neither my husband nor I are retired nor do we expect to retire for another fifteen years. However, I am very concerned with the erosion of our retirement fund. With the condition of our economy, the population outlook and the present drain on Social Security we realize that we cannot "depend" on Social Security to help supplement our retirement; therefore, we are trying to prepare for the future as best as we can without a crystal ball.

As I understand the "source tax", it will be levied by the state in which you were a resident and earned your pension benefits. My husband and I have lived in several states while saving for our retirement thus creating an administrative nightmare.

1. Living in several states while saving for retirement, do you pay each state?

2. How do you determine which portion of a mutual fund goes to each state?

3. If each mutual fund is in a different state are these states entitled to a part of the tax? (The dividends and capital gains would have been earned in that state.)

4. What happens when you live in one state and your employer is in another state and your paycheck comes from the employer's state?

5. My husband is in sales and his territory covers several different states, how do we determine just how much of our pension belongs to each state.

If our pension fund is diluted by additional state taxes, federal taxes and inflation what will we live on when we retire? Does it then become the responsibility of the federal and state government to provide for us thereby creating a need for more and higher "source tax", income taxes and etc. Creating a "black-hole" from which there is no escape is not the answer to increased revenue.

We should be encouraging people to save money thereby creating more money for capital investments which in turn would bring in more revenue. We need to be more innovative, productive and competitive in the world marketplace which would stimulate trade and increase revenue. The "source tax" is a band-aid approach to a problem that will not go away. It places a heavy burden on a segment of the population that cannot afford another assult on their already meager resources. This group, retirees, cannot simply go out and supplement their income because they are penalized with additional taxes if they earn to much money and/or they may not be in the best of health and able to work.

The "source tax" would be a costly tax to collect, an administrative nighmare and a short-sighted solution to a long term problem.

Respectfully,

Martha A. Logan

June 6, 1991

7020 Hadlow Drive
Springfield, VA 22152

Messrs. Wayne Hosier and
Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Re: Source Tax on Pension Benefits

Dear Sirs:

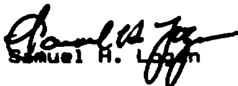
I wish to voice my opposition to the concept of taxation of pension benefits by the states based on earnings while a resident of that state.

During my federal career, I have had nine PCS (Permanent Change of Station) moves which resulted in residency in six different states and all but one have state income taxes. My total income, including my contribution to retirement, was subjected to both Federal and state income taxation. Additionally, while a resident of those individual states, I paid my share for services through other taxes, such as sales and personal property taxes. Those states also received the additional benefit for school support from the Federal government, since I was an employee at a Defense installation and had children attending the local schools. It would be ludicrous, not to mention a great infringement upon my personal freedom and a financial burden on me and my family, to expect that some day, my pension benefits would not only be taxed by the Federal government but possibly by six other jurisdictions as well.

One of our great freedoms in this country is the right to move and live in any state that we wish. A prime motivation for moving is to achieve a higher standard of living either by securing a greater income or a lower cost of living. A big component of cost of living is taxation. A person whose pension is taxed by a state where he or she no longer resides is being penalized for moving and subjected to taxation without representation, the earliest identified Un-American concept.

I urge that the Congress pass legislation which bars the states from levying a "source tax" on pension benefits.

Sincerely,



Samuel H. Logan

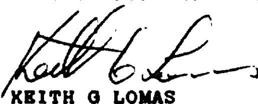
Keith Lomas
3324 N-Mt View Dr,
San Diego, Ca 92116

11 June 91

Wayne Hosier/Ed Mihalski
US Senate Finance Committee

I am writing to urge that the source tax by states against federal retirees be abolished.

I also understand that the states are only trying to collect the source tax from CONUS retirees. The hundreds of thousands of foreign and native born citizens who retired in a state, and then moved to a/their foreign country (e.g.: Mexico, Philippines,Canada, Bahamas, ect) are exempt from the tax or pursuit by the states. This is unfair! If the states are to levy a tax on non-resident retirees, it should be applied equally to all and not just the CONUS retirees, or the tax should be declared invalid.



KEITH G LOMAS

June 19, 1991

Wayne Hosier/Ed Mihalski
c/o U. S. Senate Finance Committee
Washington , D. C. 20510

Sirs:

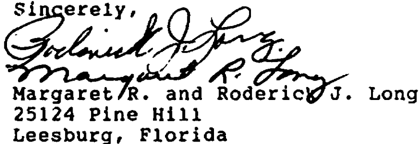
We strongly object to the so-called source tax. We have been Florida residents for almost three years.

As retirees, we receive pensions from the University of California and California State Teachers Retirement System. We have been paying California State Income Tax on these funds.

As residents of Florida, we also pay our share of Florida taxes to support services received here.

We believe this is unfair treatment and that the so-called source tax should be outlawed.

Sincerely,



Margaret R. and Roderick J. Long
25124 Pine Hill
Leesburg, Florida

Robert Lunch
[illegible]
[illegible]

14 June 1991

Mr. Wayne Hosier
U.S. Senate Finance Committee
Washington, D. C. 20510

Gentlemen:

Mr. William Hoffman will bring out most of the points in regard to why the states' source tax should be made illegal. There is a further point he may not bring out, however. That is the near-impossibility of complying.

My case is probably typical of thousands of former California residents and, I daresay by extension, to many thousands who have moved to states that have no income tax.

Since my income is too low to be source-taxable I am not obligated to pay this tax. However, I am obligated to attempt to fill our California nonresident tax forms that, insofar as I am concerned, might as well be written in a foreign language.

Fortunately, my wife is quite knowledgeable about such matters. Even so, she spent four hours trying to figure out how to respond to some of the questions in the form. After giving up she called the California tax authorities. While they were uncertain themselves as to the correct answer she (my wife) adopted one of their several responses and we mailed in the forms.

To my knowledge, no tax preparer in the state of Washington is familiar with the California tax code. No law library I know of has copies of the code.

In short, thousands of us are put in the position of being legally obligated to perform the impossible. Surely there is a law that says I cannot be held responsible for my inability to leap over a tall building in a single bound or run a mile in less than four minutes!

If you multiply my situation by many, many thousands it seems obvious that the source tax is administratively impossible. Does the State of California, or any other source-tax state, have the right to demand of us that which we cannot do?

Respectfully
Robert C. Lunch

5269 Bradgen Court
Springfield, Va. 22151
June 11, 1991

Mr. Wayne Hosier and
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

I am writing in support of legislation prohibiting the so called "source tax" on federal pensions. I am currently a federal employee residing in Virginia. Upon retirement I may leave Virginia. I do not believe I should then have a continuing obligation to pay Virginia taxes. Virginia would no longer be providing me with services, so I should no longer be taxed by Virginia. I also contend such a situation would be taxation without representation and therefore especially objectionable.

While Virginia and most States are not imposing a source tax on federal pensions, I nonetheless, support legislation prohibiting a source tax. I specifically support legislation introduced by Senator Harry Reid of Nevada prohibiting source taxes. Your consideration of my views and entering of this correspondence in the official record is appreciated.

Sincerely,

John R. MacDonald

copies:
Senator John Warner
Senator Charles Robb
Congressman James Moran
Senator Harry Reid

June 8, 1991

Hon. Wayne Hosier
Hon. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Re: Pension 'Source Tax'
Senator Reid's Bill

Gentlemen:

One of the major precipitating factors in the Revolutionary War was the issue of "Taxation Without Representation."

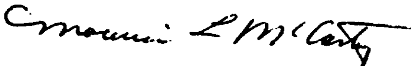
Now, over two hundred years later, the same issue is still being fought. Source taxation of pensions is, among other things, taxation without representation. I urge you to support Senator Reid's bill to outlaw this practice.

In addition to the representation issue, there is a question of equity. Source tax states only tax those that can be easily identified -- which mainly hits retired public employees. The thousands of employees of both large and small private employers who move to other states generally escape such taxation.

Although I am no longer a resident, I am required to continue to pay taxes to the State of California. I am no longer eligible to vote there, I use no services provided by the State, and I have no standing to do anything about this issue.

Therefore, I appeal to you as the court of last resort to correct this inequity by supporting Senator Reid's bill.

Thank you,



Maurice L. McCarty
2732 Persimmon Place
Williamsburg, VA 23185
(804) 253-0701

SUBCOMMITTEE HEARING JUNE, 12, 1991

S.267

WAYNE HOSIER
UNITED STATES SENATE
COMMITTEE ON FINANCE
WASHINGTON, D.C.
20510

SIR:

I AM WRITING TO SHOW MY SUPPORT FOR TAX BILL S.267. IT IS MY BELIEF THAT THE "SOURCE TAX" IMPOSED BY STATES ON PENSIONS EARNED IN THAT STATE IN PRIOR YEARS IS NOT ONLY UNFAIR TO THE PERSON RECEIVING THE PENSION, BUT IS ALSO UNFAIR TO THE STATE IN WHICH THE RETIRED PERSON LIVES. THE STATE OF DOMOCILE HAS THE EXPENDITURE FOR SERVICES WHILE THE OTHER STATE HAS THE BENEFIT OF REVENUE.

I WOULD URGE SUPPORT OF THIS BILL.

DIANE MC LOUGHLIN
POB 1298
TAHOE CITY, CA 95730

2228 Grenadier Drive
Sun City Center, FL 33573
June 17, 1991

U.S. Senate Finance Committee
Washington, D.C. 20510

Attn: Wayne Hosler
Ed Mihalski

Gentlemen:

The Tampa Tribune gave the above address for comments regarding your hearing on bills to ban source taxes.

We would not be affected by any Source Tax since we do not have any retirement income coming from any industry in any state. Our retirement is from successful investments and savings from our working years.

However, we are opposed to the concept of source taxes for the following reasons:

1. Taxes are supposed to pay for the services the citizen receives from their local or state government.

2. People who leave an area no longer create the need for government services at their previous address.

3. Once parties leave a local or state area, they become citizens of their new community and pay their due amount at this new location.

4. There is no justification for taxing retirement or bonus pay simply because the basis for such pay may have derived from employment in that community.

5. The need for tax revenue must not be permitted to allow taxation without representation when there are no current services rendered.

6. Persons on fixed incomes should not have governments raiding their retirement earnings for no reason other than the necessity for tax revenue.

7. Payment of incurred debt must fall to the current citizens of that state, not to those who have left. This must be true in spite of the fact that the state may have access to some of the money yet due the departed and locally disenfranchised citizen.

We are not sure of the right of the federal government to act on this issue, but we are deeply aware that a citizen who cannot vote has no leverage with local government officials. We must look to you for protection.

Somehow, local taxation must relate to current service.

Sincerely,

Russell E. Merritt
Democrat

Rosslyn M. Merritt
Republican

6/12/91

Mr. Ed. Mihalske
Mr. Wayne Hosier
U.S. Senate Finance Committee

My wife and I are retired and reside in Florida. Prior to retiring we lived and worked in New York and paid our share of Federal, State and City taxes. Upon retiring and living on a fixed income we found it very difficult to live in New York and make ends meet.

Upon encouragement from my brother who also lives in Florida we decided to accept his invitation and look around for permanent residence within our means. My wife and I were fortunate enough to find such a place in Florida. Now we manage to meet our monthly obligations and manage to balance our bedget.

Now here come another surprise--the so-called source tax. It is unconscionable for the States to come up with this gimmick to tax our pensions.

I was born in New York and worked in New York up until I retired--with the exception of eight years in the military and I paid every tax imaginable for a working person of my status.

I urge the Committee to bar States from imposing this so-called source tax. Please take into consideration the fact that there are thousands upon thousands in the same situation as my wife and I.

Very truly yours,

John Mikutel

John Mikutel
111 W. Goldentuft, Ct
Beverly Hills, FL. 33665
904-746-0664

John Miller
5400 Norfield Rd.
Capitol Heights, MD 20743

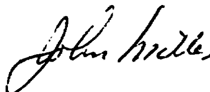
June 10, 1991

Wayne Hosier & Ed Mihalski
c/o Senate Finance Committee
Washington, D.C. 20510

For the Record:

I oppose the "SOURCE TAX", and ask my elected officials to actively support legislation to bar a state from taxing the pension benefits of people who move to another state that doesn't have an income tax.

Sincerely,



John Miller

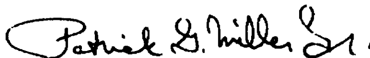
Patrick G. Miller, Jr.
713 S St., N.W.
Washington, D.C. 20001
June 6, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

To Whom It May Concern:

This letter is regarding the attached "The Federal Diary" column from the Washington Post of June 6 dealing with the issue of so-called "source taxes." This attempt to tax people who do not live or vote in a particular jurisdiction is taxation without representation. It is unconstitutional. I support attempts by Sen. Reid, or anyone else, to specifically outlaw such a tax.

Sincerely,



Patrick G. Miller, Jr.

49-891 0 - 92 - 17

June 19, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Gentlemen:

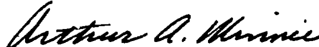
Re: Source Tax

Source income tax levied against retirement pensions of non-residents amounts to taxation without representation. These laws are so unfair that our forefathers fought a revolution over them. Yet, most taxing states have these laws and can implement or repeal them at their discretion.

I wish to urge the members of the Senate Finance Committee to support S 267 which would outlaw the source tax and would make these laws illegal. Members of Congress have exempted themselves from these laws and I ask the same for all retirees.

Thank you.

Sincerely yours,



Arthur A. Minnie
3054 Timothy Avenue
Medford, OR 97504-9752-

June 11, 1991

TO:
Wayne Hosier
Ed Mihalski
U.S. Senate Finance Committee
Washington, D.C. 20510

FROM:
T.W. Minnock
433 S. Paula Dr. #8
Dunedin, Florida 34698

RE:
Source Tax

I am strongly opposed to the source tax, i.e. California. I am a retired teacher from the state of California now living in Florida. I gave twenty seven years of my service to the state of California and to the people and students I taught.

I feel it is un-American and that this is a case again of "taxation without representation".

I strongly urge you to support the bill to outlaw the source tax introduced by Senator Henry Reid, D-Nev.

Lyle B. Morron
620 W. Sunset Strip Dr.
Beverly Hills, Florida 32665

14 June 1991

Dear Mr V Hosier & Mr E Mihalski:

Recently, I was reading the Tampa Tribune and came across an article entitled "Retiree tax may be source of discontent". The article was about a so called "source tax", imposed by a state, on retirees income even though they have left that state. I also understand that if a person moved to another state that has an income tax they could be liable for taxes to both states. This must be one of those old laws on the books and long forgotten like most of the old outdated blue laws. I never heard of it until lately. Evidently some states are scraping the bottom of the barrel to find ways to collect a few more dollars. How asinine can you get? People move for many reasons, not just to escape paying income taxes. Call a tax what you will, a tax is a tax and all states have them. Usually a tax in one state is also paid in another , although it may be called something else. I left my state, not to avoid paying taxes, but to escape the cold weather and enjoy the sun and outdoors without freezing. I am now a resident of Florida and have not found the cost of living to be much different. The article also stated that this may not be an issue that Congress can decide as there is an issue of states rights. I did not read nor have I heard anything about individual rights. Evidently these states feel that a person does not have the right to move wherever he/she chooses without them imposing their taxes on us even though we are no

longer a resident of that state. I believe a person has the right to move to any state in this country without being imposed on by the state that was left. We are no longer a citizen or resident of that state, we cannot vote in that state, therefore we no longer have representation in that state. I do not feel I have any responsiblity left to that state. A revolution was fought in this country over taxation without representation, and people should not be taxed by states where they receive no benefits and cannot vote. Many wars have been fought since and all have been over freedom and human rights.

Since reading the article in the Tampa Tribune I have read that sometime prior to January 1990, legislation had been introduced into both the U.S. Senate and the House of Representatives (S434 and HR1227) which would eliminate the source tax process and sponsored by Rep. Barbara Vucanovich (R-Nevada and Senator Harry Ried (D-Nevada). It is now June 1991 and running. Most retirees have to live on a fixed income and it is little enough to try and squeak out a half way decent life.

Taxes have been the butt of good and bad jokes since time began. However, the subject really is not funny. This is especially true of an insidious levy called the "source tax." A state should not be allowed to control a person's life or levy taxes on them once they have given up residency in that state. I trust that you and your colleagues will act quickly to eliminate this asinine law and protect the indiviuals rights.

Thank You

Lyle B. Morron

U.S. SENATE FINANCE COMMISSIONER
WASHINGTON,D.C. 20510

DEAR SIRS;

AS A FDERAL RETIRE FROM ALEXANDRIA, VA. NOW LIVING IN THE STATE OF FLORIDA. I WISH TO STATE I AM DEFINITELY AGAINST THE SO CALLED SOURCE TAX TO BE DEBATED ON JUNE 28,1991. THIS IS THE MOST UNFAIR TAX THAT HAS EVER BEEN HEARD OF. I BELIEVE SENATOR Reid SHOULD HAVE HIS HEAD EXAMINED.

Cecil Mullins

CC;
WAYNE HOSIER
ED MEHALOKI
U.S.SENATE FINANCE COMMISSIONER
WASHINGTON, D.C. 20510

Mr. & Mrs. John A. Myers
2460 Stanton Avenue
Spring Hill, Fl. 34609
June 10, 1991

Mr. Wayne Hosier
c/o U. S. Senate Finance Committee
Washington, C. D. 20510

Dear Mr. Hosier:

"Taxation without representation is tyranny!"

That statement is as true today as it was when uttered by James Otis in 1763.

When we lived and worked in Pennsylvania, we paid our taxes to Pennsylvania and received services from the state. We also had representation in Harrisburg.

We are now retired and living in Florida and we do not want to pay taxes to Pennsylvania just because our pensions were earned there.

The state of Pennsylvania is giving us zip in the way of services, and no one in the state capitol represents us. Why should we be taxed for the ineptitude of the polititians running the state. We are paying our fair share of taxes to the state of Florida, and that is enough!!

We are strongly opposed to paying taxes to a state where we no longer live or work.

Please let us know whether or not we can count on your support in this matter.

Yours truly,

John A. Myers

June 20, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Re: Source Tax

Dear Sirs:

The Source Tax should be outlawed for the following reasons:

1. It is blatant taxation without representation
2. The taxing state provides no services whatsoever to the unrepresented taxpayer
3. While the state in which we live, Oregon, does have an income tax it gives those of us an offset for the taxes we pay to California, thus depriving the state of Oregon taxes which should be pay to it. This, in turn, deprives us and other Oregonians of services in Oregon which Oregon cannot provide due to lack of funds, which must be substantial since there are so many Californians who have retired and moved to Oregon.
4. We are not trying, by this, to reduce our taxes, but simply pay them to the government entity providing us with services and representation.
5. The Source Tax, if not technically illegal, is certainly immoral and in conflict with the spirit of our constitution and should be made illegal without further delay .

Sincerely,

Frank R. Nadeau

Ruth E. Nadeau

June 7, 1991
Valmore Nadin Sr.
1613 Westerly Drive
Brandon, Fl, 33511

Gentlemen,

I am writing to you in regards to SOURCE TAXES. How can the Federal Government get involved in source taxes? To my way of thinking it is more a state matter.

Source taxing is actually taxation without representation and is to my way of thinking unconstitutional. Since retirement I moved from a state with what I considered repressive taxes in an effort to preserve my lifestyle.

After 43 years in a chemical plant I believe that the taxes extracted from me by the state were sufficient. I am on a fixed pension whose value will be dimished soon enough without the states chasing me all over the country to get more.

As my representatives I expect you to vote my wishes on this matter.

Sincerely,

Valmore Nadin Sr.

Valmore Nadin Sr.

SOURCE TAX IS UNFARE
STOP IT NOW BEFORE IT GOES TO FAR

FROM: JOSEPH A NAHAS
237 FEDERALSBURG SOUTH
LAUREL MD 2072471

6/7/91

TO: MR. WAYNE HOISER AND
MR. ED MIHALSKI
C/O U.S. SENATE FINANCE COMMITTEE
WASHINGTON DC. 20510

SUBJECT: SOURCE TAX, IT'S UNFAIR NOT ONLY TO RETIREES BUT TO TRAVELING WORKERS AS WELL.

DEAR SIRS;

THIS TAX IS A SHAME TAX, A TAX THAT SHOULD HAVE BEEN DECLARED UNCONSTITUTIONAL LONG AGO. IT IS EVEN WORSE THAN THE "AGE TAX" (CATASTROPHIC TAX ON THE ELDERLY) CONGRESS TRIED TO PUT ON RETIREES ABOUT TWO YEARS AGO.

JUST THINK OF THE MANY WAYS IT COULD BE ABUSED IF NOT STOPPED NOW BEFORE IT'S TOO LATE:

A. IRA'S MOVED TO ANOTHER STATE, WHEN YOU MOVE, MIGHT BE ATTACHED FOR REVENUE HUNGARY BUREAUCRATS.

B. SOCIAL SECURITY SURELY WOULD BE NEXT AND WHY NOT, ONCE YOU GET THE TAX COLLECTION FEVER IT WON'T END.

C. NOW WHAT HAPPENS WHEN YOU MOVE FROM STATE TO STATE, WILL EACH STATE SAY "YOU LIVED HERE 5 YEARS SEND ME 20% WHAT YOU GET, WHETHER YOU GOT IT OR NOT, AND WHETHER WE DESERVE IT OR NOT.

REMEMBER RETIREMENT DOLLARS RECEIVED ARE FROM THE SWEAT AND BLOOD AND SAVINGS OF 30 TO 40 OR MORE YEARS OF HARD WORK. IF BY CHANCE THEY BECOME SIGNIFICANT IT IS FOR SURE NOT BECAUSE OF A STATE BUREAUCRATS BUT BY THE INDIVIDUALS ALWAYS SEEKING TO DO BETTER.

THIS TAX IS A REGRESSIVE, UNFAIR BURDEN ON ANY ONE WHO WORKS AND WHO DOESN'T HAVE A VOTE IN THE MATTER.

IN TALKING TO REPRESENTATIVE TOM McMILLEN OF MARYLAND LAST YEAR, HE TOLD US THAT WHEN HE WAS PLAYING PROFESSIONAL BASKETBALL, HE HAD TO PAY A SOURCE TAX TO CALIFORNIA WHEN HE PLAYED THERE. ONE WOULD SAY THAT'S TRULY UNFAIR.

ANOTHER POINT WOULD BE THAT YOUR NEW STATE DOESN'T HAVE TO LET YOU DEDUCT YOUR OLD HOME STATES TAXES FROM A TAX LIABILITY YOU MAY HAVE IN YOUR NEW STATE.

"STOP SOURCE TAX NOW BEFORE IT'S TOO LATE"

JOSEPH A NAHAS

STATEMENT OF THE NATIONAL ASSOCIATION OF POSTMASTERS

Mr. Chairman and members of the committee, I am David E. Hyde, president of the National Association of Postmasters of the United States (NAPUS). Our organization represents 44,000 active and retired postmasters throughout the country.

We appreciate this opportunity to submit a statement for the record and to lend our support to S. 267—state tax on retirement income of non-residents.

Mr. Chairman, annuitants, particularly federal annuitants, have been used by various administrations and states either to cut deficits or to make up tax shortfalls.

The source tax is clearly taxation without representation and is blatantly unfair to retirees. Retirees, whether in the private or public sector have made their contributions to their industry and or their country and in fact, they continue to do so by paying state, local and federal taxes. The imposition of the source tax on individuals who are on a fixed income is tantamount to taking money from the poor box.

Most retirees do not live in the lap of luxury; most have worked hard to educate their children. Many have served in the armed forces and all have and continue to pay their share of taxes. All have toiled in the vineyards. Isn't it time to allow them to smell the roses without constantly getting thorns in their sides.

Mr. Chairman and members of the committee, NAPUS urges your support of S. 267 because it is right.

STATEMENT OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

This testimony of the National Association of Retired Federal Employees (NARFE) in support of S. 267 (Senator Reid's bill to ban the source tax) is authored after the invited testimony and questioning of witnesses was finally heard by Senator Bradley on June 12, 1991. Thank you for keeping the hearing record open to allow our participation. Petitioning our elected representatives is a cherished right but one denied to source taxpayers.

As you will recall Senator Bryan and Representative Vucanovich spoke in support of Senator Reid's measure and its House companion, HR 431. Later Senator Reid was able to address you and the Subcommittee. We commend his statement to you. After an intervening hearing Senator Bradley graciously heard short statements from each of three invited witnesses and then questioned them. NARFE is grateful to Senator Bradley.

NARFE enthusiastically supports the delivered and longer formal statement of Mr. William C. Hoffman, President of RESIST of America. It is our members' convention-established position that source tax is unfair in its theory and grossly so in its application. In theory source tax is the collection of "deferred taxes" that the relocated retiree has or should have planned for. This despite the fact that our members paid taxes on their contributions during their employment and under the Civil Service Retirement System receive no Social Security benefits.

In fact, only a few of 40 states are exercising the latent authority of their tax codes in seeking to collect so called "deferred taxes," interest and penalties. These few states, most egregiously California, have sought out as targets of opportunity, largely, but not exclusively public sector retirees. You may have newly arrived constituents who are not aroused now, but will be if their former state of residence seeks to tax them using the source tax. Should this occur they must turn to you as they can no longer participate in a meaningful way in the political discourse of their former state. In addition to paying taxes to a jurisdiction where they are no longer consuming government services, the new state of residence where they are or will consume resources must do so without the economic benefit the source taxed individuals would otherwise provide it in various taxes and consumer spending.

In its application the source tax has created a litany of horror stories recounted well in RESIST's testimony. While these case histories are happening in other states now, the experience will spread. Increased labor mobility (often required of our members) provides ripe targets, faster computers combing larger databases provide the means and the states' appetites for revenue to supply essential and mandated services creates demand. The problem will not go away.

Efficient administration of state government is consistent with the collection of taxes on the income of current resident citizens but inefficient and inherently discriminatory when aimed at some, easily found, former residents now domiciled in other states. On behalf of our nearly half million members throughout the 50 states we urge you and the Subcommittee to favorably report Senator Reid's bill, S. 267, the Source Tax Prohibition Act

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June 7, 1991.

Messrs. WAYNE HOSIER AND ED MIHALKSKI,
c/o U.S. Senate Finance Committee,
Washington DC.

Gentlemen: Please report to the Congress our vehement protest and opposition to the unconscionable and unconstitutional scheme of certain states to steal the income of those residing in other states through the so-called "source tax."

Such a tax is unconscionable because it extorts money from those no longer residing in the state nor receiving benefits and services from that state; they have already paid taxes for the services rendered and benefits received while they were employed in that state.

My wife and I are not retired and are now employed in Florida where we live. In the past we have worked and paid taxes in New York (4 years), Indiana (6 years), Tennessee (8 years), and Ohio (15 years). By what stretch of the imagination, justice, or common sense should the politicians of those states be entitled to tax us on income to be received from a Board of Pensions in Pennsylvania, and from salaries already taxed?

If such a tax is not unconstitutional, it ought to be. It violates one of the first principles of the American Revolution that "taxation without representation is tyranny." As a resident of Florida, I have no voice in the policies of those states in which I no longer live, but which wish to tax me for services I no longer receive.

Both my wife and I will appreciate your efforts to defeat the "source tax."

Sincerely,

FRANKLIN S. NAUMAN &
SHIRLEY (LEE) NAUMAN.

STATEMENT OF JAMES W. WETZLER, NEW YORK STATE COMMISSIONER OF TAXATION & FINANCE

New York State opposes S. 267, which would prevent states from imposing an income tax on pensions received by nonresidents. We endorse the comments made by Harley T. Duncan, the Executive Director of the Federation of Tax Administrators, but would like to add some specific references to how S. 267 would affect New York State.

Generally, New York takes a lenient approach to the taxation of retirement income. First, New York exempts all public employee pens ions. Second, New York exempts all pension income of nonresidents as long as it is in the form of an annuity, which is defined as a uniform periodic payment for a period of not less than one-half the recipient's life expectancy. Third, New York excludes the first $20,000 of pensions and annuities received by people older than 59½.

The practical effect of these exclusions is that New York will generally only tax the pens ion of a nonresident when it is received in a lump-sum distribution or other kind of nonperiodic payment. If Congress were to preempt states from taxing any pension income of nonresidents, taxpayers would have an incentive to design compensation plans under which what are, in fact, earnings would be paid out as retirement income shortly after the taxpayer became a resident of a state with little or no income taxation. This would be poor tax policy, and would very likely force New York to adopt complex rules to prevent that type of tax avoidance.

While the sponsors of S. 267 are concerned about the possibility of burdens being placed on retired public employees, the effect of S. 267 in New York would be to mandate tax relief for high-income executives and others who can design flexible compensation plans.

We are concerned about the proliferation of proposals to preempt state taxing authority. These are extremely vexatious for those of us who are trying to deal with state fiscal problems. Their sponsors rarely take proper account of the legitimate concerns of state taxing authorities, and the bills are usually poorly drafted in the sense that they have impacts well beyond those intended by their sponsors. Congress should be spending its time on ways to help states deal with their severe fiscal problems instead of on unnecessary legislation that would make them worse.

June 6, 1991.

WAYNE HOSIER & ED MIHALSKI,
c/o U.S. Senate Finance Committee,
Washington, DC.

SUBJECT: Source Tax

Dear Sirs: I urge you to vote for outlawing the Source Tax. It is very unfair for a person to pay taxes to their state of residence all their working life, move to a state which has no tax, and once again pay the original state.

I thought the Revolutionary War was fought over taxation without representation. Retirees require all the help they can get to live on reduced income, since medical and other living costs are so high.

If source tax IS allowed, in all fairness, members of Congress and other persons who enjoy the benefits of living in the DC Metropolitan area should also be taxed.

Once again, I urge you strongly to OUTLAW A SOURCE TAX.

Sincerely,

NAOMI M. NICHOLS.

Mr. WAYNE HOSIER AND Mr. ED MIHALSKI,
U.S. Senate,
Finance Committee,
Washington, DC.

Dear Gentlemen: I am writing to you requesting your support in outlawing the proposed state source tax (pension tax).

I have lived and worked in California all my life paying federal and state taxes. I worked overseas for three years paying federal and state taxes. California especially southern California is the most expensive state to live in. Because California in so populated and so expensive I will not be able to survive on a fixed income and thought of paying federal and two state taxes and possibly city tax if I choose to move out of California is beyond comprehension. I am requesting your support along with Senator Harry Reid (D-Nev) in outlawing the state source tax.

FRED A. NORTHCUTT.

STATEMENT OF THE ORGANIZATION OF PROFESSIONAL EMPLOYEES OF USDA

ISSUE

Some States have enacted legislation which levy income taxes on what is known as "sourced income," money earned while living in the State, even though you may no longer be a resident of that State. In other words, you are to pay State income taxes on that portion of your pension earned in the State. States that have "source taxes" use the rationale that workers subtracted independent retirement account contributions (not true in the case of Federal employees), and omitted their employer's pension contributions, when they reported their taxable income. Now that they are drawing the money out, the State wants its deferred share regardless of whether the worker has now moved to another State. In theory the taxes are a payment for State services received. The fact the services are no longer used is ignored. Also ignored is the fact you can no longer write your State legislator to protest. You no longer live in the State. What should be the State's share of your pension? Unless you were employed in one State all your working life, neither the States or employers have the records to compute what would require a very complex formula.

Source taxes pose a difficult situation for people drawing Federal annuities who may have been transferred to several States over their careers. They may face tax judgments from all of them. Free portability of pension rights is also an issue. Today's workers must be prepared to change jobs and move to new States to keep up with kaleidoscopic economic changes.

Currently several bills have been introduced in the 102nd Congress (S. 267, HR 431-HR 1531 and HR 1655) which would prohibit (or at least limit) State imposition of an income tax on the pension income of individuals who are not residents or domiciliaries of that State.

OPEDA'S POSITION

OPEDA is opposed to all State income source taxes" and urges its members and others to support Federal legislation (S. 267, HR 431, HR 1531, and HR 1655) which would prohibit such taxes.

Mr. Wayne Hosier
C/O U.S. Senate Finance Committee
Washington, D.C. 20510

June 7, 1991

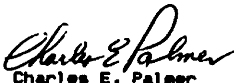
Charles E. Palmer
8273 Annapolis Rd.
Spring Hill, Florida 34606

Dear Mr. Hosier

I have just become aware of the bill to "outlaw the source tax" which is being introduced by Sen. Harry Reid, D-Nevada. I wish to express my complete approval and support of this bill and encourage its passage. As a retired person now living in Florida on my retirement income, I no longer vote or have any voice in the government of my former State of New York. Further, I paid my fair share of New York State taxes while living there and now that I no longer live there, I feel that I should not have to pay their taxes. I feel that such a tax would be grossly unfair and it would certainly be taxation without representation. I ask that you please do what you can to support this bill to its final passage

Thank you for your consideration in this matter.

Very truly yours,



Charles E. Palmer

Leroy C. Parker, Jr
2934 Elizabeth Place
Lakeland, Fl 33813

June 12, 1991

Messrs: Wayne Hosier
Ed Mihalski
In care of
US Senate Finance Committee
Washington D.C. 20510

Gentlemen:

We, the undersigned, wish to urge you to block the attempt of states with state income taxes to collect taxes from retirees who have moved to states with no state income tax. We worked and paid income taxes for forty five years in our former state, (Va.) even though our wages came from sources outside of the state of residence.

We do not believe our former state should be allowed to collect income taxes from us, as we are receiving no benefits from said state; in fact our former state is still receiving real estate taxes on idle farmland which we have been unable to sell.

If states with income taxes are permitted to tax retirees in states without income taxes, it amounts to taxation without representation, as we can not vote on any state or county ballot of our former state of residence. This means we have no control over the governmental processes of our former state, nor do we have any say in the election of the governor or any other public official.

Many of our friends and relatives contend that states with income taxes should balance their budgets, cut waste and excessive spending, and operate within their tax base supplied by their permanent voting residents, not try to collect income taxes from anyone who may have been a resident at some time in the past.

Yours truly

Leroy C Parker Jr
Frances Pettus
Gertrude Parker

8210 Southwater Ct.
Springfield, Va. 22153
June 6, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Messrs. Hosier and Mihalski:

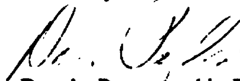
The concept of a "source tax" was brought to my attention in "The Federal Diary" of *The Washington Post* on June 6, 1991. Up to this point, I was totally unaware of such a tax. While Virginia, the state in which I reside, does not employ such a tax, I am vehemently against such a tax, dismayed that any state utilizes this tax and fearful that a state could initiate it in the future.

Firstly, such laws seem to discriminate against retirees. From the description of these laws in the newspaper, it sounds as if only retiree pensions are subject to the tax, while a person who moves from one state to another prior to retirement is not subject to the tax.

More importantly, however, my dislike for this tax is a very simple one, and perhaps "revolutionary." It is simply this: *"Taxation without representation is tyranny."* The principle that a person can be taxed on income after legal residence has changed is abhorrent. The idea that a state can levy a tax on a non-resident means that the individual has no say, enjoys no privileges, in the state which the individual continues to support monetarily. This is colonialism in its worst form, and I thought it was something we had claimed our independence from over two hundred years ago. Unfortunately, I am not up on Constitutional law, but it seems to me that this should be unconstitutional, purely and simply. It certainly throws mud at the *Declaration of Independence*.

I am, therefore, in support of that portion of the bill to be presented by Senator Harry Reid that would outlaw source taxes. Thank you.

Sincerely,



Dennis Perzanówski, Ph.D.

PSCA PROFIT Sharing Council Of America
1255 23rd STREET N.W., SUITE 500
WASHINGTON, D.C. 20037 (202) [illegible]

June [illegible]1, [illegible]

By Hand Delivery

Mr. Wayne Hosier
United States Senate
Committee on Finance
Room 231A
Hart Senate Office Building
Washington, D.C. 20510

Re: S.267

Dear Mr. Hosier:

The Profit Sharing Council of America (PSCA) appreciates the opportunity to comment on S.267, which would prohibit a state from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciles of that state. PSCA supports the purpose of S.267 and urges that the Subcommittee recommend it for passage.

Founded in 1947, PSCA is a national non-profit association that represents the interests of profit sharing and 401(k) plan sponsors and participants. Its approximately 1,200 member companies engage in every type of business activity and range in size from family-owned fledgling enterprises to Fortune 500 companies. All members depend upon PSCA to represent and advocate their interests concerning current legislative and regulatory proposals that would affect profit sharing and 401(k) plans.

As the states move to impose income taxes on the retirement income of non-residents, PSCA members are concerned about:

- The unfairness of such a tax on qualified retirement plan beneficiaries.
- The administrative burden imposed on plan administrators.
- The difficulties of enforcement.

The Unfairness

Without the passage of S.267, the retirement plan beneficiary will increasingly be subject to a double tax on payments from retirement plans unless the state of residence is willing to exclude from its own taxation amounts for which tax is paid in other states. It is unlikely that all states would be willing to waive the revenue this might involve. For example, a retiree residing in Oklahoma who worked in California could face payment of state income tax to both Oklahoma and California on the amount he or she receives.

Another burden on retirees would be the required filing of more than one state income tax return. It would not be unusual for a person who has had a long career with one company, and who has worked in numerous locations during that career, to have to file half a dozen or more tax returns. Even if the plan administrator has kept the various deduction requirements for each state, and correctly allocated and reported such payment to both the participant and the state, the filing burden on the participant would be unreasonably difficult.

The Administrative Burden

The administrative burden which would be placed on retirement plan administrators should most states decide to impose an income tax on the retirement distributions of non-residents is staggering. In such a system employers would have to account separately for the portion of each employee's retirement benefit earned in each state. They would have to report this accounting to both beneficiaries and the states. For plans which provide for a stream of payments, plan sponsors would have to make such an accounting each year for every person who receives a retirement benefit from the plan. Since federal law requires that participants be allowed to leave any benefit exceeding $3,500 in the plan upon a pre-retirement termination of employment, and since many defined benefit plans do not provide for pre-retirement cash-outs, it is possible that large companies could end up doing this new accounting for literally millions of people.

Such a development would add a whole new layer of complexity and expense to the qualified retirement plan system. Company sponsors would have to develop and implement new systems so that plan administrators could track the careers of participants by the participant's work location. For defined benefit retirement plans, this situation would impose enormous new actuarial costs on sponsors as actuaries would have to calculate the value of the participant's benefit for each state in which a participant worked in addition to calculating the benefit overall. Sponsors of defined contribution plans would have to set up separate accounts by state for each participant so that employer contributions, employee contributions and earnings on those contributions would be properly allocated.

All of this will be burdensome and expensive for plan administrators. It is to avoid this type of complexity that ERISA contains provisions allowing it to preempt state law.

Enforcement

No matter how diligent state revenue departments are, there will be offenders who refuse to pay what they will view as an unreasonable tax. There would also be retirees who are unaware that such a tax burden has been imposed on them until years after the fact, when they receive a notice of assessment from state taxing authorities.

Other variables which will add to the complexity of state taxation of non-resident retirement payments include the taxation of retirement lump sum distributions and lump sum payments made to those receiving pre-retirement distributions. Also, there is the difficulty of determining how to tax distributions from plans which offer Section 401(m) after-tax savings plans, 401(k) hardship withdrawals and participant loans from qualified plans.

In fact, for many current older employees, the records necessary to properly administer the nationwide taxation by the states of non-resident retirement income do not exist.

Conclusion

The passage of S.267 is beneficial not for what it accomplishes, but for what it prevents: a nightmare of duplicative taxation and burdensome and expensive record keeping and reporting for both qualified plan administrators and participants.

We would be pleased to discuss our comments. Please call if you have any questions.

Sincerely,

David L. Wray

David L. Wray, President

cc: Mr. Ed Mihalski
Minority Chief of Staff

July 8,1991

Honerable Wayne Hosier Ed. Miholski;

The wife and I were residends of N.Y. State and moved to Florida to retire 4 years ago.

We would like to express our thoughts in regards to the Source Tax.

We both worked in N.Y. and did pay our dues in Taxes and now we want to injoy what we collect.

We are very much not in favor of this tax what so ever.

Federal Goverment is taken taxes out,Medicare, soon nothing will be left.

Thanking you for your support.

Sincerley yours,

Mr + Mrs L Reynolds

Mr.& Mrs, L..Reynolds

June 19, 1991

Robert G. Ristow
170 Lani Way
Talent Or. 97540

Mr. Wayne Hosier & Mr. Ed. Mihalski

Senate Finance Committee

When a person becomes a permanent resident of a state, that person immediately receives many benefits and services from that state. Among these benefits are the right to vote for state and local officials, state police protection, health care services and many others. The benefits and services provided by the state impose obligations on both the citizen and on the state.

The citizen has the obligation to pay a fair amount for these services both as state income or alternative taxes and as property or other local taxes. He must behave in a law abiding manner, serve on juries and support the state that he has chosen for his home.

The state is obligated to not only provide the services, but to also insure that ALL citizens ofthe state help pay for these services in an equitable manner. However the source tax makes it impossible for the state to do this. Many retired state residents pay income taxes to a state in which they do not reside and from which they receive no benefits. By giving income tax credits to these retirees the state in which they live exempts them from paying their fair share of the costs of running the state. All residents of the state suffer because money is being used to subsidise the state to which the source tax is paid.

In 1989 the state of Oregon paid, as income tax credits, $12,992,000. These credits were given to full time permanent residents of Oregon. These credits are more than double the credits given for the same purpose in 1985 and reflect the increase in source tax collection by other states.

Sincerely
Robert G Ristow
503-535-6142

PENSIONS AS DEFERRED INCOME

The concept that the pensions of retirees are deferred income from a previous time in their lives is seriously flawed and is not a viable fiscal policy for a state that stands to lose revenue from the so called source tax. The use of this concept to justify the source tax leads to abuse. The decisions made by California tax courts are used to champion the idea of deferred income when taxing the retirement incomes of persons who have left the state. However when a retiree moves to California from another state, California stands behind the principle that a pension is income when and where received.

The IRS and most states consider pensions to be income only when received and are therefore taxable in the year received. The money that was earned to qualify for a pension, make an investment or put money into a savings account, was already taxed in the year that it was received and by the state in which it was received.

Pensions are not precalculated for a specific amount that can be assessed and billed at the time of retirement. Rather pensions have the requirement of survivability. The pensioneer must stay alive to earn each months income.

Some states, California for example, use both the concept of deferred income and the idea of income when received depending on what benefits the taxing state at the moment. Retirees living in California pay income tax to California on all income regardless of its source (Encl. 1 Column 3) a pension is income when received. If however a retiree moves from California, the pension now becomes deferred income and is fully taxed by California as "source income" (Encl. 1 Column 2).

It is obvious that the concept of deferred income as applied to retirement incomes is arbitrary and capricious. Now consider the plight of an individual who worked in four, five or more states while qualifying for a single pension. Income tax returns must be filed in each of the states, each state has its own rules and demands. The individual has the burden of proof as to howmuch each state is entitled. Tax courts or Revenue Depts. in each state must be satisfied. No American citizen should have to face that ordeal just to satisfy the financial needs of states in which he has no vote and from which he receives no benefits.

Nonresidents of California Receiving a California Pension

A pension attributable to services performed in California is California source income. California taxes this pension whether you are a resident or a nonresident of California at the time you receive it.

Example 1 — You worked 20 years in California. You retired and moved permanently to Nevada. While living in Nevada, you begin receiving your pension attributable to the services you performed in California. The taxable amount of your pension for federal purposes is $20,000.

Determination: As a nonresident of California, you are taxable only on your California source income. Because your pension is attributable to services you performed in California, your pension has a California source and is taxable by California. Enter $20,000 as the taxable amount of the pension on Schedule SI, which you must attach to your Form 540NR when you file it. Do not make an adjustment on Schedule CA to exclude the pension from total income.

Allocation. A nonresident of California who receives a pension that is attribu-

Residents of California Receiving an Out-of-State Pension

California residents are taxed on ALL income, including income from sources outside of California. Therefore a pension attributable to services performed outside California but received after you become a California resident is taxable in its entirety by California.

Example 3 — You worked 10 years in Texas, moved to California and worked an additional 5 years for the same company. You retired in California and began receiving your pension, which is attributable to your services performed in both California and Texas. The taxable amount of your pension for federal purposes is $10,000.

Determination: You are a full-year resident of California. As a California resident, you are taxable on all your income, regardless of its source. Therefore, the amount taxable for California purposes is $10,000, even though a portion of the pension is for the services you performed in Texas. Do not make an adjustment on Schedule CA to exclude any of the pension from your income

Tampa, Florida
June 10, 1991

Wayne Hosier and Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, D. C. 20510

Subject: Source Tax - Reid bill

Gentlemen,

The Reid bill needs to become law.

Some will argue that it is Federal Interference with States Rights.

States Rights end at the State Border, when they cross the state line (such as collecting the Source Tax from someone living in another state) it becomes Interstate Commerce which is a Federal Responsibility.

Thanks,

Raymond W. Robertson

Raymond W. Robertson
Apartment #1
15419 Plantation Oaks Dr.
Tampa, Florida 33647

Owen Rothberg
286 New Mark Esplanade
Rockville, MD 20850

June 6, 1991

Mr. Wayne Hosier
c/o Senate Finance Committee
Washington, DC 20510

Dear Mr. Hosier;

Mike Causey's column in the Washington Post indicated that I could make a statement for the record concerning the proposal to ban the Source Tax by sending it to your attention. As a former resident of California who will be directly affected, I want to express my opinion that such a tax should be outlawed.

I have not lived in California since 1977; I lived and worked there, as a career U. S. Government employee, from 1961 to 1977. As I understand it, the State of California considers that it has a right to tax me on my retirement benefit, based on the time that I worked in California and assuming that I move to a state that has no state income tax. The theory is that I earned a portion of my retirement benefit then and so should pay taxes to California when I get the income. In my view, the theory has no merit. I paid my taxes on my income when I lived in California. I will pay whatever taxes are applicable to the state that I live in if and when I manage to live long enough to retire. The State of California, or any other state, has no right to any portion of my income after I leave there and I, in turn, have no interests, obligations, or rights to services there. If California wanted the tax revenue from a portion of my retirement, they should have taxed the benefit at the time that I earned it. Since I was a voter in California at that time, I would have had something to say about it then.

Sincerely,

Owen Rothberg

cc: Senator Sarbanes
Senator Mikulski
Congresswoman Morella

Route 23 Box 310
Tyler, Texas 75703
June 18, 1991

Wayne Hosier
United States Senate
Committee on Finance
Washington, D.C. 20510

THIS LETTER IS IN SUPPORT OF SENATE BILL S267

HEARING DATE: JUNE 12, 1991

CONCERNING: STATE INCOME SOURCE TAX

I am supporting S267 for the following reasons.

I am strictly against taxation without representation, that is why our Forefathers fought the Revolutionary war.

The Income Source Tax is strictly taxation without representation. I am against any state taxing people who don't live in the state where the taxes are being levied.

I also do not feel that these states that are charging this "Source Tax" should be allowed to charge it on wages earned in another state, or from a spouse's retirement who never lived in that state. This is what California is doing.

California refused to send me the proper forms to fill out, and one day in February 1991 we received an outrageous bill for almost $25,000 on my retirement, and selling of my home in 1988. This included interest and penalties for not getting it filed sooner. This was their fault. We never even heard of this outrageous tax until we had been in Texas for over a year.

We do not feel it is fair for people to work a life time, and then be taxed on their retirement no matter how much they were able to put back to retire on. This money was taxed when we were working, and this is double taxation by having to pay taxes after we retire. We paid our taxes once, and once is enough.

These politicians are being overly greedy, and we want it stopped.

We don't get any good out of these taxes because we can not vote in those states, use the state parks, roads, highways, or anything else as we do not live in those states. We should not be taxed to pay for these states to run there government. Many of us have found it necessary to move to be able to live better, or educate our Grandchildren, take care of family members, or thousands of other reasons.

Retirement pay is not the only place these states are collecting this illegal tax. They also are collecting it on wage earners who are working in other state and their spouses wages who never lived in their state. Many people are paying this illegal tax to more than one or two states that one spouse or the other worked in. These states should not be allowed to add interest or penalties when they refuse to send out the proper forms on time.

I also agree with all of the statements which were stated in the hearing you held on June 12, 1991, on State Income Source Tax.

Sincerely,

Donna Rouse

Clarence S. Rouse
CLARENCE S ROUSE

Stan & LaVerne Ryan
71328 Hwy. 93
Polson, MT. 59860

Sub: S. 267 To prohibit State Source Income
Taxing of Pensions.

Dear Mr. Hosier:

If you, Mr. Hosier, retired with a pension from, let's say, a California based corporation, and then moved to Maryland and decided to go to work for the U.S. Senate, California would tax your pension,(now get this!) based upon your present total income! not just your pension! How's that for "having-your-cake-and-eating-it-too!"

Yours truly,

Stan Ryan

Stan Ryan

June 17, 1991

Senator David Boren
Chairman of the Senate Finance Subcommittee on Taxation
United States Senate
SD-205 Dirksen Building
Washington, D.C. 20510

Subject: In support of Senate Bill S.267

Dear Senator Boren:

Taxation without representation is unfair! It is wrong for states to impose nonresident income taxes on pensions and source income of retirees. Please help us to stop these unjust, unfair and unwanted taxes!

As you well know, S.267 prohibits a state from imposing an income tax on the pension or retirement income of nonresidents. Nonresidents receive no benefits or services from their former state: they cannot vote, petition or participate in that state's government. Yet they are required to pay income tax to that state.

In addition, this is money that is leaving the state of residence whereas it should be going into the economy of the state of residence. This is not right! Taxes should be paid only to the state of residence.

We ask your strong support in getting Senate Bill S.267 passed.

Sincerely

Howard and Mavis Scarff
P. O. Box 2024
Carson City, NV 89702

11 JUNE 1991

Mr. Wayne Hosier and
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Sirs:

You will shortly be holding a subcommittee hearing on several bills outlawing State Income Source Taxes. I wish to take this opportunity to encourage you and your committee to outlaw this insidious tax. This is truly a tax without representation. One is being taxed by a State without being able to vote in that State. The State receiving the tax does not provide one paying the tax with fire or police protection, street maintenance, schools, libraries, parks and recreation facilities, utility regulation or any other services one would be entitled to if one were a resident of the taxing State. The taxpayer required to pay the source tax is not able to vote for representatives to the receiving States legislative, local city/county government offices, school boards, bond issues, etc. The taxpayer has absolutely no voice in any state or local issues of the State receiving the source tax. The taxpayer is completely disenfranchised to political privileges and rights in the State receiving his source tax monies. Therefore I strongly urge you and your committee to work hard to eliminate this tax by supporting the bill introduced by Senator Harry Reid (D-Nev).

Thank you for considering my appeal and I eagerly await the outcome.

R. D. Schmidt

R.D. Schmidt
4236 Lomo Del Sur
La Mesa, Ca 91941

4728 54 th Street
San Diego, CA 92115
17 June, 1991

The Honorable Senator David Boren, Chairman
Senate Finance Subcommittee on Taxation
Washington, DC. 20510

Subj: Bill # S. 267 (Regarding State Source Tax.)
Hearing Date: 12 June, 1991, 10 AM.

Dear Senator Boren and Committee Members;

Few times in our lives do people become so outraged that they feel compelled to take time to respond. Just living in California for some 40+ years has taught me to always expect the unexpected, however, I was none-the-less "Taken Aback" when a measure of pure tax greed (known as the Source Tax) came to my unexpected attention, brought up from some endless hole of taxing possibilities. This tax (I'm sure you are aware) allows states to tax non-residents pensions or retirement annuities accumulated while working in those states. I hope you can appreciate the horrible nightmare of facing tax time for a person who worked a few years in this state, a few years in that state, and a few years in a few other states,(each state eventually wanting their respective pieces of the pie!). Also, consider the attitudes generated when states litigate other states for the collection of non payment of taxes by people residing in those states (not within their jurisdiction).

Once the General Public finds out about this tax (at this time it still is a well kept secret due to the way states are going about administering this tax) it is going to have many un-natural effects, such as the way people save their retirement monies, the effect it will have on retirement plans such as IRA's, TSP's, etc.,and especially which states they choose to work and live in. It is very demoralizing to find out (unexpectedly) about this tax after you have reached retirement age and find out that now, one might have to eventually ask for government support to enable one to make it to the end! This tax does NOT encourage people to save for old age. There is a very sickening feeling one gets when he finds out (Later) that his former representatives are still trying to "suck out lifes last blood!"

Lastly,but most importantly, is the MOTHER of all issues - - - "Taxation Without Representation". The Source Tax without doubt fits this catagory perfectly! The Source Tax is the most Un-American, Un-Democratic, unequal, unjust and unfair tax that I have witnessed. I have always been willing to pay my fair share (check my returns!) up until now. Once an individual moves to another state, he or she no longer is provided the goods or services that this tax money generates. They are not even able to vote on issues affecting payment of those very tax dollars!

Taxation has finally exceeded the upper limit of one's ability to cope. Never have I felt so hostile, never have I been so revolted by a specific issue!

I therefore urge you Sirs, to represent democratic ideals and vote for Bill S. 267.I'd like to remind you at this time of your own similar state tax issue, Art. 113, Chapter 4, of title 4 of the US Code concerning the law that exempts <u>you</u> from having to pay taxes to Maryland, Virginia and Washington,DC while you are residing in those states or even while Congress is in session!

There are legitimate ways to tax people and there are obscene ways to tax people. The Source Tax is the most disturbing I have seen.

Most sincerely,

Edward R. [illegible]

POB 925
Lakeland, FL 33802-0925
June 13, 1991

Wayne Hosler & Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, DC 20510

Dear Gentlemen;

In regard to the Reid Bill, that would make it illegal for any State to tax a Retiree's pension unless they live in that particular state. I wholeheartedly support this Bill and would ask that you provide your support to such a measure.

I worked in Ohio for most of my federal career and I paid my share of Ohio State Taxes for all those years, taxes that were levied against my salary PRIOR TO my retirement contributions being deducted from my Gross Income. What right would a state, such as Ohio, have to tax my retirement wages that I have earned in my own right, when I don't even live there?

This would smack of "Taxation without representation", gentlemen!! I certainly hope this country hasn't sunk to this level.

Please lend your support to passage of this bill or any bill that would outlaw such practice.

Sincerely,

TIMOTHY T. SCOTT

cc: Florida Members of Congress

Joseph Sena
1890 N. Atlantic Ave.
Apt. A405
Cocoa Beach, FL 32931

JUNE 10, 1991

SENATOR WAYNE MOSIER & SENATOR ED MIHALSKI
U.S. Senate Finance Committee,
Washington, D.C. 20510

We and all our friends and neighbors are against a "Source Tax"

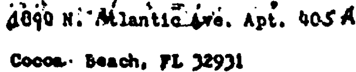
The reasons are very simple the States are spending more money than they are getting from their permanent residents that are using all their facilities. For instance NEW YORK CITY gave an increase to their teachers of 5% who are paid an average of $ 40,000.00 A year plus other benefites. All State employees are the highest paid in the nation. Pollice, Fire Dept. State Pollice are getting $ 52,000.00 A year.

We moved out of these States because of the high Taxes. Our pensions are small enough now PLEASE PASS A LAW THAT WILL STOP ALL "SOURCE TAXES"

WE ARE FOR SENATOR Harry Reid Bill to outlaw all source TAXES.

We DONT EVEN GET A CHANCE TO VOTE IN THESE STATES ON ANY EXPENDITURES.

Yours truly,



1890 N. Atlantic Ave. Apt. 405A

Cocoa Beach, FL 32931

Yours truly,

1890 N. Atlantic Ave. Apt. 405A

Cocoa Beach, FL 32931

SERVICE EMPLOYEES

INTERNATIONAL UNION, AFL-CIO, CLC

1313 L STREET N.W. • WASHINGTON, D.C. 20005 • (202) 898-3200

JOHN J. SWEENEY
INTERNATIONAL PRESIDENT

RICHARD W. CORDTZ
INTERNATIONAL SECRETARY-TREASURER

June 26, 1991

The Honorable David Boren
United States Senate
Chair, Senate Finance Subcommittee
on Taxation
SD-205 Dirksen Building
Washington, D.C. 20510

RE: COMMENTS ON S. 267

Dear Senator Boren:

SEIU is writing to express support for S. 267, which would prohibit a State from imposing an income tax on the pension or retirement income of individuals who are not residents or domiciliaries of that State, sometimes referred to as a source tax.

The issue is one of equity. Source taxes have been abused by a small minority of states to wring income from those who can least afford it and who benefit the least from tax-financed services: low income retirees living in another state.

Further, in the case of California, public sector retirees are singled out for taxation, to the exclusion of private sector employees. It is the policy of the Franchise Tax Board not to pursue private sector retirees, because it has no efficient method of tracing them. Retired state employees, however, depend on the state for their pension checks, and are therefore easy to locate, and to tax. California State Employees Association/SEIU #1000 (CSEA) represents 90,000 retired state employees who are extremely upset by this unfair treatment.

The average monthly pension for a retired California state employee is about $650 a month, or less than $8,000 a year. These are not the people the states should turn to for funds in times of fiscal distress.

The Honorable David Boren
Page 2
June 26, 1991

SEIU does not object, nor do our members, to fair taxation of pension benefits. Federal taxes on pensions, for example, are applied uniformly and fairly. Similarly, retirees living in states where pensions and other income are taxed by the state of residence should and do pay those taxes, and they benefit from the services those taxes provide. The vast majority of CSEA retiree members, for example, continue to live and pay taxes in California; they believe, however, that they deserve the choice to move without penalty.

It is consistent with the concept of deferred compensation that taxes also are deferred during active employment, and should reflect the employee's new circumstances as a retiree when paid. For example, tax rates on pensions are based on retirees' reduced income, not on the higher income they earned while active. This means pension income is generally taxed at a lower rate than would have been applied to that same income during active employment. Similarly, state taxation should not excessively penalize other normal and expected changes that occur upon retirement, including, in some cases, changes in residence.

Unfortunately, attempts to resolve these inequities in the small number of states where they occur have been unsuccessful, and have been opposed by revenue-conscious state administrations. There is in this case no remedy short of federal legislation.

In sum, SEIU urges the Subcommittee's support for S. 267. Thank you for your consideration.

Sincerely,

Peggy Connerton
Peggy Connerton
Director of Public Policy

PC/ES/pdk

June 10, 1991

U.S. Finance Committee
Washington, D.C. 20510

Members:

Please do your utmost to outlaw the "source Law". Many people moved from "source" states for other reasons than an income-free environment: health, family, freedom from cold weather.

Most pensioners have worked for years, worked under stressful conditions at times and worked loyally for little. We feel life is unstable and fearful enough at this stage without a loss of well-earned income which we have already been receiving.

Yours truly, Frederick B. Shepard

F.B. SHEPARD
2425 HARDEN BLVD - LOT 207
LAKELAND, FL 33803

June 20, 1991

Senate Finance Committee
Washington DC 20510

I enrourage you to support the elimination of the so called "source tax" to ensure states like California are not allowed to tax persons who do not reside or vote in California.

It is a tragic state of affairs when a state can unilaterally decide to take taxes without providing any type of service or benefit. State taxes were paid by persons who live in that state and enjoy the benefits of their "taxation". However, to take state tax money just because someone resided in a state for a period of time is just wrong. Taxes should be only taken from those who have some say in how the tax is spent. There is no way a non-resident can have any say in the politics of tax spending. In effect, there is a full effect of "taxation without any representation" which has been, up to now, prohibited by constitution. If this tax robbery continues to be condoned, there are no limits states with deficits will go to get more money from people who can not protect their interests. It is both unjust and immoral for California to take from people who may not pay income taxes in their state of choice, but are taxed at the level of their home state spending patterns. Why should any resident of another state be forced to pay for California's excesses.

It appears to be a Constitutional issue whereby a person should never be taxed if they have no business or residence in a state just because the state has determined to "go after" their money.

Retirees, and others, should be able to live freely within any state without having to be taxed by another state that believes it has an interest in just getting tax money and not provide any services.

The state of California has unjustly taken tax money from residents of Nevada because Nevada does not have a state income tax. The state of California has decided if a state does not have an income tax, then California will see if it can get some tax money. I do not believe California should be able to tax me for Federal pensions if I do not reside in California.

I believe this is criminal and should be stopped. Please pass a strong anti-source tax bill and prevent robber states from unjustly taking money from citizens of other states.

Sincerely,

Richard Sheresh
395 Lemire Court
Chula Vista, CA 92010

Herman A. Sinemus
12000 S. Brierwood Pt.
Floral City, Fl. 32636

June 22, 1991

Subject: Non-resident state income tax

Dear Senators Wayne Hosier & Ed Mihalski :

This letter is written in regards to your committee work about state income tax. More specifically, it is about non-residents being taxed on their pension from a state. My pension is from California. I have permanent residence in Florida. I have paid California State Income Tax for the six years of my retirement. It just doesn't seem right.

Admendment X of our Constitution gives States the powers not delegated to the United States by the Constitution.

Amendment XVI gives Congress the power to lay and collect taxes on income.

Does this mean that Congress has the power to control all taxes on Income from whatever source? Are States Rights pre-empted?

Does State Income mean interest on an employee's contribution forever?

If Congress has power over income tax, they should eliminate the state income tax or place regulations on the tax. One such control could be interest earned on funds within the state are taxable. Also, any Federal monies are non-taxable. It would add more work and may not be worth the effort or cost.

We should be reasonable in our taxing exercise. It is possible for citizens to Unite in TAXATION WITHOUT REPRESENTATION. I believe there is some truth to that statement in this good old U. S. of A.

Please consider the above in your Honorable judgement about source taxes and the impact on the public.

Sincerely,

Herman A. Sinemus

cc. Senators Graham and Mack

June 11, 1991

Dear Mr. Wayne Hosler:

We live in Florida only by chance primarily because of my wife's severe arthritis and not being able to stand the cold Michigan weather and closest to our families and for the climate my wife can feel more comfortable in. Arthritis is not curable and she has been a victim for 60 of her 73 years, with over 40 surgeries and the expensive medication she is on. We are retired but not able to really enjoy retirement as such.

We both worked very hard for what we receive now, and to have to be deprived of our fixed income to help finance the "Short Falls" should not be up to the senior citizen who now is at the mercy of poor health and the many many unscrupulous Big Business, entrepreneur, banks, Savings & Loans, etc., and it appears that in today's news 4-5 judges are accused of money scams in Fort Lauderdale. In our Florida House of Representatives and Senate our leaders are spending my money for trips and meetings all over the U.S. and abroad and you expect us "Ist Class Senior Citizens" who have made Florida what it is today and will be in the future to build this state up with our meager pensions and Soc. Sec. while the Government sends Billions and Billions of dollars overseas to support everyone else except us at home?

United States and Florida have more than enough problems with medical gouging, hungry and homeless, jobless and crime and dope. If the Big Wigs would look into our back yard instead of their selfish interests we and America and each state could possibly eventually be the greatest country in the world.

We are falling so behind in education, helping and making jobs for the new Graduates, it's pitiful.

Take away the freebees from the politicians and make them earn what they were voted in for. Stop loaning Big Business money for businesses that are ½ to 3/4 empty even before they are a few months old, or never rented in the beginning.

Our roads are deplorable throughout, sales tax has been raised for roads three times, but it takes 6 or 7 years to start after a date set to begin.

In the meantime new commissioners and other governing officials are put into office and the price of roads, sewers etc. goes double or more. Our Social Security and pension does not qualify for us to uphold all the Millionaires that are in the Senate and House of Representatives & Congress etc. How did they become Millionaires?

Perhaps a telephone employee for 30 years and Magna Cum Lauda graduate from the common sense school of hard knocks could do as well as they do!

Please veto any bill that would make Florida residents pay income tax on pensions earned and paid by other States. Can you include all retirees all over the world? Where does one go to live and so-called enjoy retirement to the best of their health and income to get away from gouging?

Sincerely,

Vitold & Nadia Smailis

June 12, 1991

1851 Pennsylvania Ave. NW
Washington, DC

U.S. Senate Financing Committee
U.S. Senate
Washington, DC 20510

Abolition of State Imposed Source Taxes

Statement for the Record

This issue is one of charging for services not rendered. In plain English, source taxes are theft. As a political movement, source taxes are the type behavior seen in classic colonialism. From a historical standpoint, such behavior on the part of officials has led to the overthrow of the offending government.

Sincerely,

John Smith

(attachment)

Identification and Control of Organisational Malfunctioning

Socialist/Colonialist Cults

INTRODUCTION

Louis Pasteur, the French medical research scientist, once said that where there are suitable hosts, there will be equally suitable parasites feeding upon those hosts. Unfortunately, the principle applies to two legged parasites as well as microbes. In the human environment, the two broad classifications of such cults are SOCIALISM and COLONIALISM. The picture is clouded by the fact that in certain types of occupations, socialist/colonialist orientations provide a socially beneficial function. Additional confusion is generated by the fact that problems such as ignorance, greed, over development, and various natural disasters tend to mask the impact of socialist/colonialist activities.

This article outlines characteristic behavior that exposes socialist/colonialist activities. Action is required to prevent initiation of their destructive activities, to put an end to their activities once started, and to minimize the damage caused in those cases where their destructiveness is in an advanced stage of development.

The first step in the process is identification of the source of the organizational malfunctioning (socialist, colonialist, or neither), since it determines the required course of corrective action. The second step is to eliminate the source of the malfunctioning and to take steps to prevent future reoccurrences.

SOCIALISM

Any time a clear pattern of destructive activities is seen, socialist activity should be suspected. This might involve strikes, layoffs, business failures, wars, extermination campaigns, high unemployment, or the public ownership of private resources.

The Socialist - The Person

In most cases only their actions will reveal the true intent of socialists, and these will be carefully covered up. In some cases socialists are sloppy in regard to cover ups; exhibiting readily identifiable behavior:

1. Socialists are natural born actors. They proliferate in the motion picture industry as well as various political positions. They see no inconsistency between being helpful one minute, and viciously attacking the next. All of the actor traits may be seen - cosmetic surgery, impeccable dress, holier than thou behavior, verbosity, use of extreme language (words such as absolutely, never, always, and sometimes profanity), and uninhibited behavior.

2. Their charisma will charm you into submission. As politicians, they are the worst of the demagogues, and most grandiose of the megalomaniacs. Whether they are considered great, too good to be true, superficial, callous, vicious, or egocentric; the pattern of destructiveness remains.

3. They frequently have a history of starting out small and working their way towards bigger and better things, both in personal development and destructiveness. Attacks begin with easy marks such as the elderly and the disabled. As national leaders, their objective is to destroy the entire country (and eventually the world). They are the pirates of the business world.

4. Any excuse is a good excuse for destructiveness. If you make the mistake of providing them with support, you will be eliminated as a potential competitor. If you oppose them, the same fate awaits you.

5. Frequently they are found in positions where they simply don't belong. For instance the grade B artist who becomes a national leader. In females, they may exhibit masculine strivings.

6. Their intolerance of externally imposed burdens may lead them to murder their children, trash a business, etc.

The Socialist in the Organization

In an office environment and supervisory position, they like to start by firing the entire staff. Hires have to measure up to their standards. A favorite technique is to cut 50% or so of the staff each year, and to make sure that any long term survivors are terminated.

Business piracy involves the creation of short term profits by firing personnel, cutting any new initiatives (no new business), and butchering the victim business to provide immediate profits for the pirates, with creditors assuming the risk for any losses. Such management is irresponsible, unreasonable, short sighted, and self serving by any standard. Piracy does not require an external take over. Groups within an organization can butcher it as easily as raiders external to the organization. Unions are frequently a strong source of support for such activities.

The Socialist in Government

It goes without saying that mass murder is characteristic of most socialist governments. Expansion into neighboring countries, by force if necessary, is also characteristic. Anything destructive that can be done, is done. A peculiarity is the political doctrine of public ownership of private property. Your only mode of transportation must be public transportation, your housing will be provided by the state, your health care will be state provided, etc. They love racism (including sexism, age discrimination, etc.) and the creation of cults of superiority (plenty of awards and hero medals). They like to think of themselves as the master race. Propaganda is that of demagogues, the big lie (we are for the people, of the people, we always win, we are always right, we accept no criticism, etc.), and terrorism (if you disagree with us, you will be shot). They are reactionary - wars will be fought with obsolete equipment and tactics (frequently mixed in with some new technology), relying upon brute force tactics. In a war, they maximize losses for their own troops. A country's industry becomes extremely backward and outmoded. They destroy the economic and cultural foundation of their victims. Trade in narcotics (e.g. alcohol) is rampant. Achievement of their ultimate goals will leave only the scattered remnants of a dead civilization.

COLONIALISM

Any time a clear pattern of the misutilization of resources for the benefit of special interests is seen, colonialist activity should be suspected. This might take the form of excessive taxes, various levies against salaries, squandering of resources, over development, non-competitive procedures, monopolistic practices, restrictions imposed upon the public use of public resources, the private ownership of public resources, or any other exploitation of public resources by private interests.

The Colonialist - The Person

In most cases only their actions will reveal the true intent of colonialists, and these will be carefully covered up. In some cases colonialists are sloppy in regard to cover ups; exhibiting readily identifiable behavior:

1. Colonialists specialize in pleasant congeniality, without the occasional rage sometimes seen in socialists. Even when mad they do not appear to be particularly excited.

2. Their expansion is in the arena of ever larger empires. Sometimes bizarre interests are seen, such as building a large collection of antique cars.

3. Their rigid inflexibility and love of detailed procedure may be obvious. Whether they are considered grand, too good to be true, vicious, callous, egocentric, or a robber baron; the pattern of exploitation and obstructiveness remains.

The Colonialist in the Organization

In an office environment, dipping into the till is everything. The production of legitimate products at legitimate prices is irrelevant. Business dealings are frequently bizarre (but place cash in the right pockets). The power of monopoly is abused. They are the robber barons. Resources that should have been used to ensure the viability of the organization are diverted into personal fortunes. Employees are a commodity to be used in the same manner as a lump of coal, and have the same rights.

The Colonialist in Government

As politicians, they institute programs to defraud entire countries. A peculiarity is the doctrine of the private ownership of public property. No restrictions upon the masses or privileges for the few are ever too absurd to be implemented. A pattern of outright gifts, lucrative contracts, grants, subsidies, etc. make overnight millionaires of the right people. No tax or charge is ever too absurd. Lucrative manipulated pricing and taxing schemes may be imposed. Military force is used only as a last resort. Economic enslavement is preferred over terrorism. Like the socialist, they love racism and big lies. The concentration of national resources in the hands of the few frequently becomes such an economic burden that insurrection results. They will wrap the chains of servitude and indebtedness around your neck for eternity. Achievement of their ultimate goals will leave the victim country completely depleted of all resources; capable of supporting only a relatively small, impoverished population.

508 Plaza Ave.
Lake Placid, FL 33852
June 12, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Gentlemen,

My wife and I, both ex-teachers are Pennsylvania pensioners who now live in Florida.

We wish to state our opposition to any Federal approval of a <u>source</u> <u>tax</u> which would tax our Pennsylvania pensions.

We began to work in 1940 at the even-then starvation wage of $1170.00 (eleven hundred, seventy dollars) per year. Our subsequent salaries, although improved over the original amounts, were always inadequate to our needs as family providers.

Please use your considerable influence to ensure the defeat of any action which would result in the imposition of source tax.

Sincerely yours,

Martin L. Stapleton

Martin L. Stapleton

10287 Abbott Road
Manassas, Virginia 22110
June 24,1991

Wayne Hosier
U.S. Senate Finance Committee
Washington,D.C. 20510

Dear Mr. Hosier:

I am writing for the purpose of informing you of my support for Senator Harry Reid's bill which would outlaw the source tax.

As a result of my Federal employment, I am subject to relocation to any place that my agency deems my services are needed. I pay taxes to the state/locality in which I live. I do not obtain a "free ride."

Upon my retirement, I will continue to pay taxes in one form or the other to the state/locality in which I live. To have the state/locality tax me after I retire for the monies I earned while living in that location before retirement is, at the very least, unfair. I paid taxes to that locality while I was there. Other than political expediency, how can that locality justify a tax on my income which is not earned as the result of any activity in that locality?

I do not support the source tax. Please outlaw it.

Sincerely,

Frank Steele

STATEMENT FOR THE RECORD SUBMITTED BY
PAUL E. SULLIVAN
(FEDERAL RETIREE, CSA-2-424-699)
FOR THE HEARING ON SOURCE TAX LAWS
BY THE SENATE COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510
JUNE 26, 1991

At the end of 1980 I retired from Federal employment with credit for 36 years' service, most of it in the Washington, D.C. area. Parts of my service, however, were performed elsewhere; in all I worked in over a dozen States, but paid State taxes only where I resided most of that time in Virginia.

At the end of 1989, because I found Virginia to be unethical in tax matters, I moved to New Hampshire. After I moved I learned that any State can tax a pension as deferred compensation if pension credit was earned in its jurisdiction. I also learned that one State I served in has a program for tracking down any retiree who earned part of a pension while working there; then the retiree is found delinquent and assessed taxes, penalties, and interest for all the years since retirement. Under that system even a tax amount originally small becomes significant and the retiree is an attractive collection target.

I have no idea when that State or other States will find out that I am still alive, retired, and ready to be plucked, but I know I need legal protection against that threat.

1778 N Marian Avenue
Thousand Oaks, Ca 91360
June 21, 1991

Members of the Senate Finance Committee:

I am writing to voice my enthusiastic support for legislation which will outlaw source taxes and eliminate the ability of a state to tax the pension income of a non-resident. Rather than dwell on the true but overused saying of 'no taxation without representation', I thought I might present a few other reasons as to why source taxes should be banned.

First, I should mention that I am a federal civil servant employed at a navy base in Southern California. The source tax is particularly painful for the retired federal employee because almost all of the pension is fully taxible. For a worker in private industry whose total pension includes a sizable non-taxible Social Security benefit, the source tax would be less painful but still onerous.

In a business law class, I recall studying a Supreme Court decision (circa 1968) which stated that a state could not impose a sales tax on an out-of-state mail order company that did not have a 'physical presence' (like a store) within that state. I cannot help but contrast this law with the plight of thousands of retirees who move to another state, leaving no 'physical presence' (such as real estate) behind them, and lo and behold here comes their former state to impose a source tax on the retiree's pension!!! I realize that these are slightly different situations, but I fail to see how any state can tax you for anything if you don't live there and if you have no 'physical presence' in that state. By any measurement standard that you care to use, thousands of retirees ought to have the same taxation rights and privileges that a mail order company has, yet unless you change the law, they don't!!!

And in case you haven't thought about it, enactment of a law to ban source taxes will actually enhance fédderal revenue. Since retirees would have less state source taxto use as a deduction on their federal income taxes, their federal taxes would be higher.

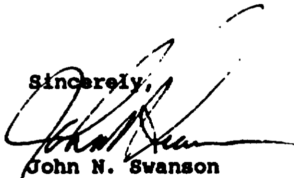
Also, sooner or later there will be a big outcry about the current practice of military personnel being able to select a legal state of residence during their period of active duty. The fact that they can escape having to pay source tax by selecting a state that doesn't have it is particularly galling to federal civil servants since we work side-by-side with them throughout their military career.

And finally, I'm mad at the state of California for waiting 25 years to tell me that they were going to tax my fedoral pension forever if I moved out of state.

It's time to ban source taxes. It just simply isn't right to permit this practice to continue.

Thank you for your time.

Sincerely,



John N. Swanson

Robert L. Talbert
7200 Pirates Cove Rd.
Bldg.#28 Apt.#2097
Las Vegas,NV.89128

June 17th, 1991

Wayne Hosier & Ed Mihalski
c/o U.S.
Senate Finance Committee
205 Dirkson Building
Washington, D.C. 20510

U.S. Senate Finance Committee:

Taxation Without Representation is unfair! It is wrong for States to impose nonresident income tax on pensions and source income. Please help us to stop these unjust, unfair and unwanted taxes on retirees. I ask your support in getting Bill S.267 passed. this is a rare opportunity to support legislation that is needed and will not cost the Federal government ONE RED CENT! Please vote "YES ON OUR bILL- s.267. thank you.

Sincerely

Robert L. Talbert

4728-54th St.
San Diego, CA 92115
June 14, 1991

United States Senate
Committee on Finance
Subcommittee on Taxation
Washington, DC 20510

Subject: Bill S. 267, June 12, 1991 Subcommittee on Taxation Hearing

Dear Senator Boren and Committee Members,

Bill S. 267 is one of the most important issues dealing with taxation that I have seen in my lifetime. The so called "Source Tax" that this Bill addresses is presently a nightmare for millions of people wanting to re-locate to find some PEACE in their waning years. This "measure" of pure tax greed, that has come up from some endless hole of taxing possibilities, I find most un-American. It already has caused hatred between states, terrible grief among some of our elderly who have worked hard and saved that little, precious part of income that MIGHT enable them to survive to the end without government aid, and it has caused much anxiety for those who have had to work in many different states to earn their living. I could go on and on about the many un-natural effects that will be occurring if this taxing practice is allowed to continue.

One of the founding principles of this nation is that there shall be NO TAXATION WITHOUT REPRESENTATION. The "Source Tax" is a clear cut violation of this principle. I believe it is fair for a retiree to pay state taxes to the state in which the retiree resides. As a resident, the retiree benefits from the goods and services provided by the state, which are generally paid for by those state taxes. And as a resident, the retiree has the chance to participate in the democratic process.

But for a state to tax a retiree on pension income simply because once upon a time the individual worked in that state is ludicrous and unconstitutional. If the retiree is not a resident or current worker, he reaps no benefits from the goods and services those tax dollars provide. And as a non-resident, he cannot participate in the democratic process. The pension income cannot be treated in the same sense as "earned income." While a person is working or living in a state, state taxes are fair. The person either by working or by living in the state, makes use of the goods and services of that state, and should pay a fair share of the tax burden. Pension income is not earned by CURRENT labor, and cannot be treated the same as other earned income. Don't forget that during employment an individual pays taxes to the state in which that money is earned.

I would like to remind you at this time about your own state tax issue, Art. 113, Chapter #4 of title 4 of the U. S. Code, concerning the law that exempts YOU from having to pay taxes to the states of Maryland, Virginia and Washington, DC while you are working there. Please, Sir, people should be taxed fairly and only in the state of residence. I urge you and all your colleagues to represent democratic ideals and VOTE FOR BILL S. 267.

Most sincerely,

M. J. Taylor

6805 Haven Avenue
Oxon Hill, MD 20745
June 6, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, DC 20510

Gentlemen:

Regarding the Senate hearing on a bill to bar a state from taxing the pension benefits of people who move to another state that doesn't have an income tax, I am all in favor of this ban.

I am currently a civil service employee who will be eligible to retire within three years. One of my options upon retirement is to move to Florida, not because of the tax advantage, but for the warm climate and fishing. No state tax is just an additional benefit.

I do hope that Senator Harry Reid's (D-Nev.) bill to outlaw the source tax passes upon introduction to the Senate. I lived and worked in California prior to moving to Maryland. Without this ban Maryland would be able to tax my retirement income should I retire in Florida. But isn't is possible that California would try to also get their "pound of flesh"? After all, I did work there for a couple of years.

I support any effort to outlaw the source tax.

Sincerely,

Richard B.C. Tom

Joyce M. Tyler
6737 Friars Road, #192
San Diego, California 92108

13 Jun 91

U. S. Senate Finance Committee
Washington, DC 20510

Dear Members:

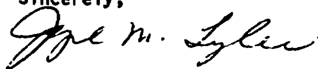
I wish to go on record stating that I am opposed to anyone being required to pay Source Tax to any state in which he/she is not a resident. <u>It is wrong</u> for a person to be required to pay taxes to a state that no longer represents him/her.

My husband and I have written letters to our Congressmen stating my opposition to the California Source Tax, but have not received a response on this issue.

I am a California resident and a Federal employee. When I retire, I want the freedom of choice to reside wherever I decide without being taxed by another state.

Source Tax is "**TAXATION WITHOUT REPRESENTATION.**" It's time for the States' greed to end.

Sincerely,



Statement of Tony Connole, Vice-Chairman,
UAW West Central Florida Retired
Workers Chapter,

Before The Senate Finance Committee
United States Senate

An article in the Tampa Tribune of June 7, 1991 stated that Senator Harry Reid has introduced a bill which would outlaw any state from imposing an income tax on former residents who retired to another state after having earned pension income while residing in such former state.

My organization opposes any such "source income tax" for the reasons hereinafter set forth.

This type of source tax would be eminently unfair and burdensome to those who have retired to another state. Most retired persons have relatively low and static incomes which have already been reduced in purchasing power by the increases in the cost-of-living. Increases have been particularly large in the categories of food, utilities and medical services, all of which consume a greater share of retired persons' incomes than those categories consume of the incomes of those not retired. This, of course, would increase and make even more harmful the burden of any source tax applied to retired persons.

Every state seems to suffer currently from budget problems, and all are seeking additional sources of income. We sympathize with those state problems, but submit that a source tax on income would not produce significant income for any state.

To permit source income taxation would create such complicated problems as to defy solution. During their years of employment, many retired persons exercised that that great American privilege of mobility and resided in several, or many, states while earning their pension entitlements. Each state would contend that they were the only state with the right to impose a source income tax on such retired person. Punitive and contentious claims could be made by one state in competition with others. Many construction and service occupations normally travel throughout the country in the course of their worklife. Any effort to determine which state(s) have a right to impose a source income tax is fraught with contention and complication.

The final impact of a source tax would encourage states to take punitive actions against other states in areas totally unrelated to the source tax. The

national government should not, by their action, encourage such punitive activities among the various states.

Any claim that retired persons should be subject to source taxation because they have escaped income taxation by moving to a state without an income tax is completely in error and ignores the nature of taxation in such states. The tax picture in Florida is a case in point. By failing to enact a state income tax, Florida has by-passed the opportunity to have a progressive type of tax. In an effort to meet their budget requirements, Florida has relied heavily on the sales tax and the real estate tax. These two taxes are particularly regressive since they impose a heavier burden on those with low and middle incomes than on the rich. A recent study by Citizens for Tax Justice ranked Florida third worst in the nation in this regard. Poor people pay five times as much of their income as rich people do, while middle income households pay almost three times as much.

"Low and middle income" describes virtually all retired persons. In other words, retired persons residing in states without income taxes already carry a disproportionately large share of the total tax burden. They should not be asked to increase that burden by a state in which they no longer reside. A federal ban on source income taxation at least would not increase this unfair burden.

Retired persons are among the most patriotic and supportive citizens in the nation. Having worked a lifetime in the democratic and freedom-loving environment of our nation, and having earned the right to retire with only a moderate level of economic security, they have not been overly demonstrative in viewing and discussing the inequities and insecurities of our nation. They prefer to relax and enjoy the fruits of their retirement. But this could change, and the imposition of a source income tax could well trigger a vehement reaction among the increasing number of retired persons in our nation.

In behalf of my organization, I respectfully urge that the Congress outlaw source income taxation.

Tony Connole
44 Douglas St.
Homosassa, FL 32646

Tony Connole
June 8, 1991

326 Snowy Butte Lane
Central Point, OR 97502

June 19, 1991

Wayne Hosier and Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Gentlemen:

It is my understanding from a recent article by Mike Causey, The Washington Post, that the Senate Finance Committee's taxation subcommittee will be holding hearings on several bills, one of which would outlaw the source tax. In line with that article, I wish to make you aware of my dissatisfaction with the source tax.

I was a Federal employee for 31 years and worked in Illinois, Texas, California and Utah. Upon retirement I moved to Oregon which has a state income tax. At present, I must file state income tax returns in Oregon and California. If all states pursued this source tax as diligently as California, I could conceivably be required to file state income tax returns in all four states.

My disagreement with the source tax is based on the fact that in each state, state income taxes, property taxes and sales taxes were paid to that state while residing there. Why should any individual continue to pay taxes to a state where they no longer reside. It is rather like continuing to pick the bones after a death. I strongly protest the continuance of such a tax and hope that you will outlaw such taxes.

Thank you for your attention to this matter.

Sincerely,

Imogene S. Vancavage

June 9, 1991

Mr. Wayne Hosier and Mr. Ed Mihalski
U. S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

I wish to express my opposition to the "Source Tax" bill or the "Reid Bill" as introduced by Senator Harry Reid from Nevada.

I have a pension coming from Beatrice Foods Company which was headquartered in Illinois. I was born and raised in Iowa and served one-third of my career with Beatrice Foods Company in Iowa, one-third of my career with Beatrice Foods in Illinois, and one-third of my career with Beatrice Foods in Wisconsin. Now I am residing in Florida and expect to earn a cumulative salary at least as much as I earned in the first three states.

Now what state is going to tax my pension? Is it Iowa, Illinois, Wisconsin, or Florida -- or all of them?

I feel that the state where I choose to reside has no bearing on where my pension benefit was earned. I have paid my fair share of taxes in each state that I have lived in and I refuse to pay taxes to another state that I no longer reside in. Let these states offer me an incentive to remain in their state -- such as job opportunities or tax incentives to encourage me to remain.

Additionally, I am also a member of the American Association of Retired Persons (AARP) and support their efforts in opposition to this bill.

Please give my remarks your sincerest consideration.

Respectfully Submitted,

Mr & Mrs. Richard Vaske

Mr. & Mrs. Richard L. Vaske
3719 Casaba Loop
Valrico, Florida 33594

June 7, 1991

Wayne Hosier & Ed Mihalski
c/o U.S. Senate Finance Committee
Washington DC 20510

Dear Sirs:

I am in favor of legislation to bar a state from taxing the pension benefits of people who move to another that doesn't have an income tax.

The so-called "source" tax is unfair to senior citizens. Please relay this message to the U.S. Senate Finance Committee.

Thank you,

diAne A. Vick

diAne A. Vick
5500 S. 7th Road
Arlington VA 22204

2104 Harleston Place
Sun City Center, FL 33573

June 10, 1991

Wayne Hosier & Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, D. C. 20510

Gentlemen:

The purpose of this letter is to let you know of my concern and to request your assistance to get legislation enacted prohibiting States from imposing Source Taxes on their former residents.

For your information, my Federal Retirement is the result of 20 years of active military and almost 13 years of civil service.

I firmly believe that imposing so-called "Source Taxes" on individuals who have changed their permanent residence to another state is totally unfair. If I have to pay taxes to a State while I live there, that is part of my obligation to that State. It is not right that I have that obligation after I leave that State and change my permanent residence to another State.

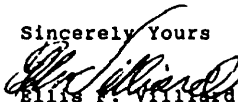
I believe that Federal Law, including Supreme Court Decisions, should prohibit any State from imposing source taxes on individuals who have moved to another State and then changed their residence to the new State.

There are those who have alluded to a possible case of States Rights. I ask you and the members of the Senate Finance Committee, do States have the right to gouge people who used to reside in their State? Is that not Taxation without Representation?

Please Help! A Federal Law is needed to prevent such robbery and wrong doing.

Thank you.

Sincerely Yours



Ellis F. Villiard

copies to: AARP & NARFE

To: Wayne Hosier/Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

10 June 1991
San Diego, CA

Fm: Richard L. Walker
4676 Tivoli St.,
San Diego, CA 92107

Subj: SOURCE TAX LAW

The justification for the source tax as embraced by the State of California would warm the cockles of King George's heart. It was the same line he tried to use on those upstart colonists in 1760, 1765 and later in 1772.

Alas - All he got for his trouble was a monstrous tea party and the final dissolution of any claims that England had laid upon the richest and most prosperous territory ever discovered by mankind.

And now, two centuries later, the ghost of English tyranny revives in the form of the most repugnant and reprehensible taxation statute conceived since that incident in Boston Harbor.

I have a great deal of trouble convincing my friends that a law exists which will follow them with a tax obligation no matter where they choose to live and that they will be forced to support a state government from which they receive no benefit. Since 1776, we have set examples copied throughout the world in defining freedom, independence and the right to pursue our own individual aspirations. We have always stressed that taxation without benefit or value to the individual is wrong and unlawful. California and other states seem determined to take us back to a pre-independence condition where taxes may be imposed at the whim of any Johnny-come-lately legislator.

Every Congressman and Senator who supports the source tax should be ashamed to show his or her face in public. The very idea of such a tax casts an ominous shadow over our personal liberties and contradicts the principles on which this country was founded.

I urge you to stand and vote against any and all source taxes, either in existence now or those which may be proposed in the future. I also encourage you to support Barbara Vucanovich's House bill which prohibits the concept of a source tax.

Thank You,

Richard L. Walker

JUNE 10 , 1991

SENATOR WAYNE HOSIER & ED MIHALSKI
U.S. SENATE FINANCE COMMITTEE,
WASHINGTON , D.C. 20510

We and all our friends and neighbors are against a "Source Tax"

The reasons are very simple the States are spending more money than they are getting from their permanent residents that are using all their facilities . For instance NEW YORK CITY gave an increase to their teachers of 5 % who are paid an average of $ 40,000.00 A year plus other benefites. All State employees are the highest paid in the nation. Pollice, Fire Dept. State Pollice are in $ 52,000.00 A year.

We moved out of these States because of the high Taxes.Our pensions are small enough now PLEASE PASS A LAW THAT WILL STOP ALL " SOURCE TAXES"

WE ARE FOR SENATOR Harry Reid Bill to outlaw all source TAXES.

We DONT EVEN GET A CHANCE TO VOTE IN THESE STATES ON ANY EXPENDITURES. Or use any of their facilites.

Youre truly ,

Mr. & Mrs. John C. Weldon
1860 N. Atlantic Ave. Apt. 404 B
Cocoa Beach, FL 32931

P.S.THE NEXT STEP TOLLS TO ENTER EACH STATE & TARRIFS.

June 10, 1991

U.S. Finance Committee
Washington, D.C. 20510

Members:

Please do your utmost to outlaw the "source Law". Many people moved from "source" states for other reasons than an income-free environment: health, family, freedom from cold weather.

Most pensioners have worked for years, worked under stressful conditions at times and worked loyally for little. We feel life is unstable and fearful enough at this stage without a loss of well-earned income which we have already been receiving.

Yours truly,

Rose Marie Whitney
2425 Harden #205
Lakeland, FL 33803

11740 Glen Mill Road
Potomac, MD 20854-1915
June 14, 1991

Wayne Hosier & Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, DC 20510

Gentlemen:

Please add my voice to those in opposition to source taxation as described in The Washington Post column "The Federal Diary" by Mike Causey on June 6, 1991.

When a person moves to a different tax area he/she should be liable for income taxes only in the area to which he/she has moved. It is utterly pernicious of a state to go after people who have moved away and are no longer a services burden to that state.

Thank you,

Meredith G. Williams

(Mr.) Meredith G. Williams

CC: Senator Mikulski
Senator Sarbanes
Representative Byron

(Original and 5 cc to principal addressees.)

June 18, 1991

Mr. Wayne Hosier
Mr. Ed Mihalski
c/o U. S. Senate Finance Committee
Washington, DC 20510

Ref: Source Tax on Pensions

Dear Sirs:

I try to be a law abiding citizen and pay my fair share of taxes.

However, when a state wants to collect more tax when you no longer live there is in my opinion, a criminal act. It may be a state law but any state that has such a law and tries to collect such a tax is nothing but a cheap thief and its leaders have no morals and could care less about a person that has worked most of their lives to draw a small pension.

I was born in Texas and worked there many years for the U.S. Government. I have also worked for the USG and lived in New Mexico, Louisiana, overseas and am finishing my USG career living in the state of Virginia. Living in Virginia, I pay state income tax, state and local sales tax, personal property tax; and yes, there is a tax on just about anything you buy or do there. If I move from the state of Virginia why should I owe them anything because I have paid my fair share of taxes while I lived there.

Whatever state I might move to, I will pay a state tax of some kind. Let's stop this unfair so called source tax on pensions, before it gets activated all over the country. Please support a bill that will outlaw a very unfair source tax.

Sincerely,

J. B. Willis, Jr.
9000 Vernon View Drive
Alexandria, VA 22308

Mr. Marion H. Willis
87 Pine Street SMW
Homosassa, FL 32646-9139

June 12, 1991

Messrs. Wayne Hosler & Ed Mihalski
U.S. Senate Finance Committee
Washington, DC 20510

Gentlemen,

While I receive no income at the present time from another state, I have and probably will from time to time. I cannot, for the life of me, see what right a state has to tax me when I neither reside there nor partake of their various services, highways, etc..

The state of California has been doing this for years, taxing me as far back as 1968 while I lived in Connecticut, because my check originated in California, even though I even avoided visiting there as much as possible.

While I am concerned with the right of the Federal government to get involved in state rights, the right of American citizens to live free of taxes imposed by states other than their chosen state of residence cannot be controlled by the states themselves, unless some means is provided by the Federal government.

I have the same concern regarding sales taxes imposed on mail order purchases!

Cordially,

Marion H. Willis

cc:Hon. Connie Mack, Sen.
Hon. Bob Graham, Sen.

June 19, 1991

12 Lida Circle
Carson, Nv.
89706

Mr. Wayne Hosier
United States Senate
Committee on Finance
Washington, D.C. 20510

Subject: S-267, Source taxing by states.

Mr. Hosier;

I strongly urge the Senate Finance Committee to vote favorable on S 267, against states taxing the retirement pension of a person who is not a resident of that state or domiciled there. I feel that this type of taxation is unfair, unjust and not in line with the principles that created our constitution.

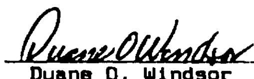
I am a former native Californian, retire from federal civil service in 1983. My contribution to my retirement fund was taxed at time of earning. After retiring, by the end of August 30, 1988, I had paid California taxes on the contribution of my employing agency, D.O.D. Because of this I feel that California has received taxes on all contributions to my rewtirement fund, called "deferred compensation" by them.

Most of my retirement is now made up of cost of living increases, nothing to do with "deferred compensation". I also wish to draw the committees attention to the fact that approximately 60% of my annuity is from Treasury Department investments in federal securities that can't be taxed by states by federal law.

On top of that, the way California law is practiced by the F.T.B., I must include any income from Nevada. I have figured it out that even with ratioing by California standards, I am paying California about 5% taxes on income earned in Nevada! <u>This is not correct!</u>

Again, please vote favorably on this bill and allow it to go before the full Senate with the Committee's recommendation.

Sincerely;



Duane O. Windsor

Mr. Wayne Hosier, Mr. Ed Mihalski
c/o U.S. Senate Finance Committee
Washington D.C. 20510

10 June 1991

Dear Mr. Hosier, and Mr. Mihalski

I am writing to you over concern that I have involving the State of California assessing a source tax on the retired Federal employee who retires from the Federal Government while in California and then moves out of California to live and is then required to pay a California source tax on their pension earnings.

The State of California Franchise Tax Board states their reasoning behind this as follows: While working in California the employer paid into the employees retirement fund, and that during this period of time the State of California deferred all taxes on the portion of the retirement fund that was paid by the employer into the employees retirement fund.

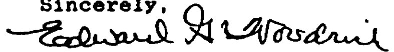
This scenario may be true for the employee in private industry, but it does not hold true for the Federal employee. As you know the Federal employee pays 7% of his salary each pay period into the Civil Service Retirement System (CSRS) which is not matched by the Government each pay period.

This money is already taxed off the gross earnings to the State and Federal government before the retirement is deducted. In no way does the Federal Government match this amount that is deducted each pay period and therefore no tax on the retirement is deferred as the State of California claims.

I then ask you this question; How can the State of California tax a Federal retiree's pension when he is not residing in the state? This is definitely taxation without representation. The Federal retiree is paying taxes to a state that he is in no way represented by, or is a resident of the state the source taxes are paid to.

Currently there is a bill being reintroduced before Congress by Rep. Barbara Vucanovich, this bill is H.R. 431 which will prohibit states such as California from collecting source taxes on retiree's pensions of those retiree's who no longer reside in the state. I urge your help in ending this unfair tax. Thank you.

Sincerely,



Edward G. Woodrich

June 11, 1991

U.S. Senate Finance Committee
Washington, D.C. 20510

Attention: Mr. Wayne Hosier
Mr. Ed. Mihalski

Gentlemen:

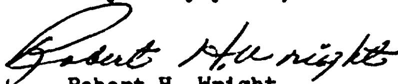
According to the news media, a Senate Finance Subcommittee is holding a hearing on whether to bar States from imposing so-called source taxes.

Please be advised that I strongly object to and oppose source taxes of any type which will adversely affect those on fixed incomes--in most cases pensions.

It is difficult enough to live on a fixed income without a source tax which is taxation without representation.

Please convey my objections to the Committee regarding source taxes.

Very truly yours,



Robert H. Wright
3527 North Honeylocust Drive
Beverly Hills, Floride 32665
905-746-0715

June 7, 1991

Virginia Zwieg
9080 SW 213th Terrace Road
Dunnellon, FL
32630

U.S. Senate Finance Committee
Washington, D.C.
20510

Attention: Wayne Hosier and Ed Mihalski

Gentlemen:

I am writing to express my concern over the source tax that is being considered and wish to express my support for the bill proposed by Senator Henry Reid which would outlaw such a tax.

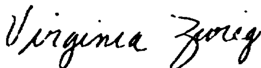
I am a retired school teacher from Wisconsin and am now a resident of Florida. My total retirement pay from Wisconsin is $683.04 per month. A source tax, imposed by the State of Wisconsin, would reduce that by an estimated $40.00 to $50.00 per month.

While a resident of Wisconsin I accepted the tax obligation imposed not only because I had to, but because I was enjoying the services provided by my tax payment. Now I am not in a position to use the services provided by Wisconsin and do not believe that I should have to pay for something I do not get.

I am not permitted to vote for any person seeking public office in Wisconsin, so any tax on my modest retirement pay is a classic example of "taxation without representation" - an evil that our ancestors died to abolish.

I urge you to prohibit any collection of a source tax by any state.

Very truly yours,



Virginia Zwieg

cc: Senator Harry Reid
Senator Connie Mack
Congressman Cliff Stearns

June 7, 1991

Wayne Hosier & Ed Mihalski
U.S. Senate Finance Committee
Washington, D. C. 20510

Dear Sirs:

SOURCE TAX?! What will we get taxed for next?

I am not wasting your time nor mine to spell out my anger on this subject by writing five pages, i.e., my allowable letter space, but if I have to pay a source tax to the state of California after having lived there 20 years and paying my taxes properly those 20 years, I'll have to see it snow in the Bahamas first.

My husband and I had to sell our home in California to move to Florida to take care of his ailing, elderly parents, and now we have to pay a "source tax" to California? NO WAY JOSE!!!!

Thank you for reading my anger,

no signature needed as I am sure there are many people in these same circumstances.

[COMMENTS ON S. 649—REPEALING THE LUXURY EXCISE TAX]

STATEMENT OF THE AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION

The American International Automobile Dealers Association (AIADA) represents more than 9,700 new car and truck franchises marketing international automobiles in the United States. Our members and their 240,000 employees sell and service imported cars and trucks in the United States, as well as vehicles produced domestically by their international automobile manufacturers. AIADA appreciates the opportunity to submit to the Taxation Subcommittee our statement on S. 649, legislation to repeal the luxury excise tax on boats.

AIADA believes that the bill, S. 649, considered by the subcommittee at the June 12 hearing is too narrow in its purpose of repealing only the luxury excise tax on boats. All of the luxury excise taxes are harming the industries subject to the tax and are costing federal and state governments badly needed revenue. Furthermore, this tax represents inherently bad tax policy and is clearly not collecting revenue from high-income individuals as was intended. Therefore, it is AIADA's position that all of the luxury excise taxes should be repealed. While our statement will focus on the effect that the luxury excise tax has had on the automobile industry, many of the problems we will address have been witnessed in the other industries subject to the tax as well.

INJURY TO INDUSTRY

The 10 percent luxury excise tax was enacted as part of the Omnibus Budget Reconciliation Act of 1990. The tax applies to the sales price exceeding $30,000 for automobiles, $100,000 for boats, $250,000 for planes, and $10,000 for furs and jewelry. The objective of the tax was to raise revenue from high-income individuals by taxing their purchases rather than their income, with a larger goal of improving the progressive distribution of tax burdens within the tax system.

It is clear from just the first three months of the tax that the targeted high-income individual is avoiding the tax by not purchasing these so-called luxuries, including high-priced automobiles. Instead the tax has had unintended, harmful consequences for the industries subject to the tax. For example, a first-quarter Economic Impact Survey of AIADA's luxury-line dealers revealed that sales of $30,000-plus automobiles dropped a dramatic 45 percent in the first quarter of 1991, compared to sales of those same cars in the first quarter of 1990.[1] It is our belief that a significant portion of that drop is directly attributable to the luxury excise tax.

While the luxury excise tax was touted as a progressive measure, just the opposite has proven true. It has been the middle-income dealership employee who has borne the greatest burden of this regressive tax. Lost sales at the dealership ultimately result in employee lay-offs. AIADA estimates that more than 3,700 dealership employees have been laid-off as a direct result of the luxury excise tax in the first four months alone.[2] In an already depressed automotive industry, the luxury excise tax is depressing luxury automobile sales even further and threatening the economic viability of many luxury-line dealers and the jobs of their employees.

Some argue that the recession is the cause of the drop in luxury automobile sales. However, sales of all cars in the U.S. in the first quarter of 1991 were down 18 percent from the first quarter of 1990.[3] The luxury excise tax has clearly caused an even greater drop in sales than the recession. Furthermore, it is not simply the recent downturn in the automobile sales coupled with the price increase from the luxury excise tax that has devastated the luxury-line dealerships. There is also a perception among customers that he or she is paying thousands of dollars in taxes

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[1] *AIADA Economic Impact Survey*. April 26, 1991. See attached.
[2] *AIADA Economic Impact Survey*. April 26, 1991.
[3] *Automotive News*. U.S. car and light truck sales. April 8, 1991.

and getting nothing in return. It is the combination of these factors that has caused sales of luxury cars to drop to such a low level.

LOSS OF GOVERNMENT REVENUE

As sales of $30,000-plus automobiles fall, so too does government revenue—and in many forms. With fewer sales, the government collects less luxury tax, less gas guzzler tax (which represents substantial revenue from many of the vehicles in this price range), less import duties, and less state sales tax. As dealership employees are laid off, revenue from federal payroll taxes, state and local sales taxes and social security taxes are lost and unemployment compensation increases, not to mention the ripple effect on the economy as a whole.

The loss of all of this revenue, the increase in government expenditures for the unemployed and the cost of collecting and administering this tax, make the luxury excise tax a net revenue loss for the federal government. In fact, a study of the revenue impact by the FAIRTAX Coalition estimates that the luxury excise tax on automobiles will cost federal and state governments at least $135.5 million in 1991.[4]

It should be noted that the projected revenue estimates calculated by the Joint Committee on Taxation (JCT) for the individual luxury excise taxes are fundamentally flawed. During the development of the budget reconciliation bill, Members of Congress and the JCT staff did not have sufficient information upon which to base revenue estimates for the individual luxury excise taxes. Therefore, their revenue estimates are an educated guess, at best. Furthermore, the JCT revenue estimates do not include many of the above mentioned revenue losses that result from lost automobile sales and dealership employment.

BAD TAX POLICY

Contrary to the stated objective of the luxury excise tax, there is no basis upon which Congress can assume that the tax substantially improves the progressive nature of the tax system. As stated in the April 2, 1991, Congressional Research Service (CRS) *Report for Congress*, "For most of the history of U.S. excise taxation, however, the policymakers who devised the taxes knew almost nothing with certainty about the distribution of purchases of the products they proposed to tax. Even today, when surveys of consumer habits and characteristics are common, there is little information." [5] Soon after the budget reconciliation bill passed, a Treasury Department official stated that the staff of the Joint Committee on Taxation felt that they did not have enough data on the distributional effects of the luxury taxes and so the taxes "never—at any stage—served their purpose of offsetting the other excise taxes in terms of the distribution of tax burdens." [6]

Furthermore, when the select few members involved in the budget negotiations last year chose the "luxury" items for tax, they had no objective, factual basis upon which to base their choices. For example, why is a $40,000 automobile assessed a $1,000 "luxury" tax, yet a $100,000 painting results in no luxury tax at all? Again, as stated in the April 2nd CRS *Report for Congress*, "taxes have frequently been targeted on goods thought to be luxuries, but judgments as to what constitute luxuries have been highly subjective." [7] The fact that other goods, which are traditionally thought of by the American public as "luxuries," were not subject to the tax suggests that the goods selected for taxation were chosen out of political necessity, rather than a conscientious effort to improve the progressive nature of the tax system. Select American industries and their employees should not be forced to bear the burden of a tax policy based upon such arbitrary decisions.

Last year, while AIADA and the industries facing the prospect of a luxury excise tax made every effort to inform the Budget Summit Conferees and the Senate and House tax writing committees of the potential problems of the tax prior to voting on the budget, industries were not given the opportunity to provide Congress with much needed input. No hearings were held and there was very little if any, consultation with the targeted industries. In short, the luxury excise taxes were drawn up hastily and in virtual secrecy, with devastating consequences for the industries subject to this tax.

[4] *Economic Effects of the Automobile Luxury Tax*. A study by Temple, Barker and Sloane for the FAIRTAX Coalition. May 1991.

[5] *History and Economics of U.S. Excise Taxation of Luxury Goods*. CRS Report for Congress. Updated April 2, 1991.

[6] Michael Graetz, Treasury Department Deputy Assistant Secretary for Tax Policy. November 9, 1990.

[7] CRS Report for Congress.

INHIBITING SAFETY TECHNOLOGY

By depressing sales of high-priced automobiles, the so-called luxury tax will inhibit the development of important safety technology and its introduction into the marketplace. Historically, the automobiles targeted by this tax have been world leaders in the development and implementation of state-of-the-art safety technology, including such life-saving features as air bags and anti-lock brakes. While these manufacturers bear the research and development costs, this technology has now become more and more available across all product lines as the technology has been refined and the production costs for such life-saving features are reduced. The luxury excise tax will inhibit the introduction of leading automotive technology, including safety features, that could ultimately benefit all consumers.

CONCLUSION

The consequences of the luxury excise tax for industries subject to the tax have been greater than Congress had anticipated. Nor did Congress anticipate the reaction of consumers to the tax, and the resulting loss in government revenue. On both counts, Americans are losing. Congress should act now to repeal all of the luxury excise taxes and prevent any further damage to the economy and American workers.

AIADA thanks the subcommittee for the opportunity to submit its views on S. 649 and looks forward to assisting the subcommittee in an effort repeal of all of the luxury excise taxes.

Attachments.

AIADA Economic Impact Survey

April 26, 1991.

Note: Total Surveys Mailed 1,515 (to MB, BMW, PORS, JAG, AUDI); Total Surveys Returned = 372 (25 of surveys mailed)

1. Has the imposition of the luxury excise tax on automobiles caused you to lay off any employees?

Answer: Yes = 253 (68%) No = 119 (32%)

Comments: Many indicated that future layoffs were planned if poor sales continue.

2. If yes, how many?

Answer: 926 (projecting with 1,515 luxury dealers = 3,704)

Comments: Responses were as of April 26, 1991.

3/4. Difference in number of vehicles sold in excess of $30,000, 1st quarter 1991 vs. 1st quarter 1990:

Answer: 6,637 less units sold (projecting with 1,515 luxury dealers = 26,548 less units sold)

Comments: This represents a 45% drop in sales (6,367 less units sold divided by 14,608 total 1990 sales).

5. How many demonstration vehicles have you taken out of service as a result of the tax?

Answer: 622

Comments: 56 indicated that they removed all of their demonstration vehicles.

6. At what mileage do you typically take a demonstration vehicle out of service?

Answer:

(1) 6,000 (102 responses = 35%)
(2) 5,000 (82 responses = 29%)
(3) 3,000 (23 responses = 8%)
(4) 4,000 (17 responses = 6%)
(5) 7,000 (9 responses = 4%)

Comments: Answers ranged from 1,000 to 25,000 miles.

7. At what mileage does your financial institution require "curtailing?"

Answer:

(1) 6,000 (58 responses = 49%)
(2) 5,000 (17 responses = 14%)
(3) 10,000 (15 responses = 13%)
(4) 12,000 (4 responses = 3%)

Comments: Many of the responses for this question were based on time.

8. Is personal use of "luxury" demonstration vehicles important to your continued viability as a "luxury" automobile dealer?

Answer: Yes = 304 (89%) No = 37 (11%)

9. Has the imposition of the tax and the IRS regulations for the tax resulted in a loss of parts and accessories sales?

Answer: Yes = 271 (83%) No = 54 (17%)

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16 May 1991

The Honorable Lloyd Bentsen
Chairman - US Senate Finance Committee
SH-703 Hart Senate Office Building
Washington DC
20510-4301

Dear Mr Chairman

I understand that your Committee is holding hearings on S-649, a Legislative Bill to repeal the 10% excise tax on certain boats.

The British Marine Industries Federation (formerly the Ship and Boat Builders National Federation) is the national trade association representing over 1,200 firms in the small ship and the whole of the pleasure boating industry.

Our members manufacture and sell - at wholesale and retail level - boats, engines, and associated equipment ranging from electronics, through fittings, to clothing.

I would like to share with you and the Committee, for your record, the UK experience with a similar tax 15 years ago, from my perspective as Chief Executive of the British Marine Industries Federation. That experience suggests the urgent need to repeal the tax.

In 1975 our Government increased the Value Added Tax rate from 8% to 25% on all pleasure boats and boating equipment. Immediately, sales stopped, and layoffs of staff accelerated. Within months many companies were headed towards receivership and inside of a year our industry was devastated.

Boat sales in the UK in the period when 25% VAT was in force were almost nonexistent. Many people delayed the purchase of a new boat during 1975 realising that the determined protests of boat manufacturers might well gain a favourable response in the next budget.

Unemployment in our industry soared to over 30%. There were 7,500 redundancies out of a total of 25,000 people directly employed in the UK boating industry.

Most of these people were middle-class, skilled and semi-skilled workers. Our industry has a great tradition of craft and skills training; these people were lost to our industry and many did not return. The staff supported our protests through petitions to our Parliament and organized parades of boats through London and regional boatbuilding centres.

... /

BRITISH MARINE INDUSTRIES FEDERATION
(A COMPANY LIMITED BY GUARANTEE)

Registered & Head Office:
BOATING INDUSTRY HOUSE · VALE ROAD
OATLANDS PARK · WEYBRIDGE · SURREY KT13 9NS
Telephone: Weybridge (0932) 854511 · Facsimile: (0932) 852874

Registered No: 2592536

We were able to convince our Government that their revenues dropped dramatically because our customers were just not prepared to pay what they saw as a 'too high' and unjust tax.

With the reductions in staff and companies in receivership, the whole foundation of our industry was undermined; exports were badly affected, investment in innovation and new designs of boats had stopped. From being the leading European boatbuilding country we dropped behind France, Holland and Scandinavia, who were all continuing their new boat development programmes. Our sailboat manufacturers have never recovered their original pre-eminent position; our power boat manufacturers took ten years and a massive investment in new boat models to retain their European market strength.

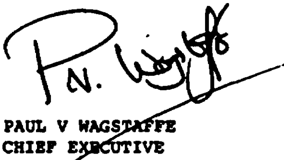
Your 10% excise tax will, I am sure, repeat the UK experience with its major, adverse customer reaction, and in all of its undesirable consequences for job loss and government revenue loss.

Our 25% tax was, eventually, reduced and all goods and services returned to a standard rate of Value Added Tax. The subsequent investment by the industry and the restoration of its home market provided an overall increase in UK tax revenue. This firm home base led to a substantial growth on boat and equipment exports which brought added revenue to the United Kingdom.

The whole bad experience was unnecessary, and the burden of the tax fell mostly, and unfairly, on the hard-working people in the boating industry.

From hard-learned, personal experience I urge you to repeal this mistaken tax policy and to act to repeal the excise tax as quickly as possible.

Yours sincerely



PAUL V WAGSTAFFE
CHIEF EXECUTIVE

June 18, 1991

Messrs. Wayne Hosier and Ed Mihalski
U. S. Senate Finance Committee
Washington D. C. 20510

Gentlemen:

It should be apparent by now that the efforts to assist the country's economic slump by placing a luxury tax on boats costing over $100,000 was counterproductive.

Because of the unfair market conditions imposed on them by the government, some boat building companies have suffered a loss in sales, and in doing so it has cost the government lost revenues in business and sales taxes. The loss of jobs for people that had to be laid off at boat building companies costs the government and states in those employee's lost income taxes, and also costs increased unemployment benefits, further weakening the economy.

Now just how far will the government go to ruin an already weak economy? Let's not add to the cynical phrase "we're from the government and we're here to help you."

The idea was bad in concept in the first place because for many people, a boat isn't a "luxury" item, it's HOME. For many people, their boat serves as their sole residence and represents all their life's savings and work. Boats are perceived as a luxury only because of the courage of some people to invest all their money into something they truly love while others meekly stand around in envy and complain that anyone with a big boat should be soaked for taxes, user fees. and any other revenue that the authorities can dream up.

Most people would have a hard time picturing themselves paying $100,000 for a home of less than about 300 square feet of living space that had the hell taxed out of it at every opportunity, but that's what a boat home is. And that's luxury??!! Humph.

Repeal the tax on boats costing over $100,000 and do some justice to the economy, the boat building industry, and America's hard working citizens.

Martin D. Conyac
6171 Morning Glory Road
Alexandria, Virginia 22310

June 18, 1991

2694 Mattox Creek Dr.
Oakton
VA 22124

Wayne Hosier
Ed Mihalski
c/o U.S. Senate Finance Committee
Washington, D.C. 20510

Dear Sirs:

Re: proposed "luxury tax" repeal

I am not a pleasure-boat owner, and I have no plans to buy one. However, I do work hard for a living and I object to another ill-conceived Congressional scheme to extract more taxes from the public.

The new tax on expensive boats is a disaster for the builders of boats, the skilled manual laborers, not for the wealthy buyers. Countless laborers loose their jobs, and both "luxury" boats and the less expensive boats disappear from the market. The government looses taxes, exports decline, people suffer, the rich buy foreign boats, and foreign boat manufactures profit. This disaster was as predictable as death and increasing taxes.

What happened to common sense and knowledge of elementary economics? I hope that Congress will display some overdue wisdom about how life works and repeal this mistake.

Sincerely,

Michael Fenton

That sinking feeling

Care for a look at "tax fairness" in action? Check out the effects of the new luxury tax on boats, a product of last year's budget agreement.

In their quest to reach a deal, lawmakers signed onto taxes to raise money from automobile users and beer drinkers and cigarette smokers. But these are regressive taxes, disproportionately affecting low-income citizens, a problem at election time.

So lawmakers and administration officials decided that poor folks wouldn't mind paying more in taxes if only they knew rich people were being soaked too. That led to a federal luxury tax on cars and planes and, yes, boats that cost more than $100,000. The Joint Taxation Committee came out with all kinds of reassuring data about the increased revenues lawmakers could expect. On a $200,000 boat, the tax amounts to $10,000 — mere pocket change for the kind of corporate yachtsmen that negotiators assumed were buying these boats.

But it wasn't long after the tax took effect in January that the whole scheme began taking on water. People stopped buying new boats. They bought used ones, or they did their shopping in the Bahamas, whose government was lowering boat taxes about the time the United States was raising them. A once-bustling boat yard in Connecticut was "virtually abandoned," the New York Times reported, and "a strange quiet" filled the air. A Carver Boat Co. subsidiary in Rocky Mount, N.C., shut down production in February. Pearson Yachts Corp. of Rhode Island, the world's oldest builder of Fiberglas boats, filed for bankruptcy in March. And the distress signals continue to mount as the tax hits an industry already suffering from the recession.

With shutdowns have come layoffs — the blue-collar kind. The National Marine Manufacturers Association, which originally predicted that the tax would cost 8,000 people their jobs, has since raised the number to 19,000. Obviously putting people out of work hasn't done much for federal revenue enhancement: Jobless people don't pay much in income or sales taxes. Nor has it done anything for one of this nation's net-export industries except cripple it.

But the larger point is that when the feds set out to soak the rich in this case, a lot of non-rich people took a bath. "Rich people don't build boats," one boat maker told Insight magazine. "The average working man builds boats. Nobody in our company owns a Hatteras yacht. Unfortunately, it's the working person that is paying the price of this luxury tax." Scores of lawmakers have signed up to repeal this version of tax fairness, 90 House members from both sides of the aisle at last count. The Senate Finance Committee has scheduled hearings on the tax for next week. We hope the jobless find that comforting.

STATEMENT OF THE MARINE RETAILERS ASSOCIATION OF AMERICA

Thank you, Mr. Chairman and distinguished Senators. I am Phil Keeter, the Executive Director of the Marine Retailers Association of America. MRAA is the national trade association of 3,500 small businessmen and women who sell recreational boats, boat equipment, and operate marinas. Our members come from virtually every state in the country, and MRAA is closely aligned with about 120 regional, state, and local marine trades associations.

We at MRAA want to thank Senators John Breaux, John Chafee, and Claiborne Pell for introducing S. 649, as well as the nine other Senators who have co-sponsored the bill to date. We also want to thank you, Mr. Chairman, for your leadership in holding this hearing.

In addition to the distinguished Senators who have sponsored S. 649, we also want to thank Congressmen Clay Shaw, Neil Abercrombie, David Bonior, Paul Henry, Ray McGrath. Ron Machtley, Tom Petri, Jim Saxton, Larry Smith, and Guy Vander Jagt who are original co-sponsors of H.R. 951, the companion bill to S. 649 in the House of Representatives, and the 86 other co-sponsors of the House bill to date.

MRAA strongly opposes the recently passed provisions in the Budget Reconciliation Act of last year which contain a 10 per cent Luxury Tax on the sales value of new recreational boats exceeding $100,000. The members of MRAA are opposed to the Tax because:

- We believe we have been wrongly singled out to unfairly reconcile the Federal budget deficit when the marine industry has been a positive contributor to the American economy by being a net exporter and by providing a growing tax base and
- The Luxury Tax is not raising the anticipated Federal tax revenues.

In addition, we are opposed to the Tax because:

- The Tax is causing massive unemployment of blue collar workers,
- The Tax is causing massive business closings of boat manufacturers,
- The Tax is causing massive business closings of boat dealers,
- The Tax is not raising the anticipated tax revenues of state and local sales taxes,
- The Tax has caused significant reductions in corporate and individual state and Federal taxes,
- The Tax has caused significant increases in the costs of unemployment benefits to displaced workers, and
- We believe administration and enforcement costs of the Tax are not only far exceeding original projections, but also the very revenues generated from the Luxury Tax.

Recreational boaters and the boating industry are suffering from a flooding sea of new taxes and fees. In addition to paying well over $200 million annually to the Federal government in excise taxes on marine fuel and fishing tackle, recreational boaters are faced with:

- increased VHF radio license fees,
- increased state and Federal fuel taxes,
- increased slip taxes and/or access ramp fees,
- increased trailer taxes and fees,
- increased state sales taxes and, in some cases, a personal property tax,
- increased fresh and/or salt water fishing licenses,
- increased Federal and/or state park fees, and
- increased proliferation of state Luxury Tax proposals.

The timing of the Luxury Tax could not have been worse. The recreational boating industry is in a deep economic downturn with 1990 new boat sales down over 40 per cent from 1988, a year of record sales and the base year for Joint Tax Committee projections of Luxury Tax revenue.

Since the start of 1991, our industry has deteriorated even more. Sales of boats retailing over $100,000 this year are nil. We believe this has been caused primarily because of the effects of the Luxury Tax. MRAA through the Advisory Council of Marine Associations, an organization of state and local marine trades associations, is in the process of conducting a sales and employment survey of boat dealers. Preliminary results of over 100 reporting boat dealers, representing approximately 40 per cent of the dealers selling boats exceeding $100,000, show boat sales down 89 per cent in the first quarter of 1991 compared to the first quarter of 1990.

These dire sales figures have resulted in downsizing of employment at marine dealerships. These same 100 plus boat dealerships have also reported a 45 per cent reduction in jobs. Assuming a hypothetical scenario of extending this 45 per cent job

loss total to the 486,000 [1] people employed in the recreational marine industry, we would find that more than 200,000 people could lose their jobs.

In addition, many businesses have closed operations. At the end of last year there were approximately 17,780 recreational boat businesses in our country. Based on a mailing we made at the end of February to all people in the recreational boat business, we had to purge our mailing list of about 2,000 addresses. These people, have ceased operations, and we expect many more dealers may be closing their businesses soon after the summer selling season.

What originally was a "Tax the Rich" scheme by Congress has resulted in a catastrophic jobs loss issue affecting tens of thousands of blue collar workers many of whom are having extreme difficulties obtaining employment elsewhere because of the recession our country is suffering from.

With the loss of thousands of jobs and the closings of hundreds of businesses involved in manufacturing, retailing, and servicing recreational boats, we have also seen an increasing number of ancillary businesses that serve the recreational boating industry, such as, banking, tool supply, materials supply, shop equipment, boat equipment and accessories, marine services, and other related business services suffering from the effects of the Luxury Tax.

I hear stories every day of dealers reporting comments of prospective customers who have decided not to purchase boats affected by the tax. We have also found that the buying public believes the Luxury Tax has been placed on the industry on the whole. We believe the implementation of the Luxury Tax has had an adverse effect on sales of boats under the $100,000 threshold. In fact, many potential buyers are also telling us that they do not like to be singled out and will not buy or trade up because of the Tax.

I also hear stories that dealers will be unable to make capital improvements to their facilities, necessary environmental improvements, and expansion.

Our industry needs your help to survive. In fact, I ask that you help save a very important American business. REPEAL THE LUXURY TAX!

Mr. Chairman, I ask that the preliminary results of our survey be entered into the hearing record. We will keep you and your staff informed as additional survey results are received. We will be updating the survey with sales and employment figures for the second quarter and we will be receiving data on sales of boats less than $100,000.

We again thank you, Mr. Chairman, for your leadership in holding this hearing and ask for your support to move on S. 649, a bill that would save the marine industry and would save jobs in the industry. We at MRAA will work closely with you and your staff to answer any questions that may come up.

[1] Industry employment figures were obtained from "Boating Safety Dollars At Work" published by the National Association of State Boating Law Administrators.

ACMA

ADVISORY COUNCIL of MARINE ASSOCIATIONS

Providing Support for the Marine Industry through MRAA

THE SURVEY INFORMATION BELOW IS THE RESULT OF ASSOCIATION MEMBERS OF ACMA
The units and values reported by the following states are on vessels over $100,000
The figures reflect activity for first quarter 1990 and first quarter 1991.

STATE	NO. DLRS REPT.	NO. UNITS 1990	NO. UNITS 1991	NO. UNITS DIFF	% DIF	TOTAL $ 1990	TOTAL $ 1991	$ DIFF	% $ DIFF	AVG. VALUE 1990	AVG. VALUE 1991	DIFF IN VALUE	EMPLOYMENT INFORMATION EMP 90	EMP 91	DIFF	% DIFF
KENTUCKY	1	6	0	-6	-1.00	$818,893.00	$0.00	($818,893.00)	-1.00	$136,482.17	$0.00	($136,482.17)	21	10	-11	-0.52
FLORIDA	23	164	45	-123	-0.75	$70,646,665.00	$9,008,538.00	($61,638,127.00)	-0.87	$430,772.35	$200,189.73	($230,582.61)	1358	668	-690	-0.51
TEXAS	1	3	0	-3	-1.00	$1,146,510.00	$0.00	($1,146,510.00)	-1.00	$382,170.00	$0.00	($382,170.00)	8	5	-3	-0.37
OHIO	6	46	6	-40	-0.87	$6,530,000.00	$1,020,000.00	($5,510,000.00)	-0.84	$141,956.52	$170,000.00	$28,043.48	202	149	-53	-0.26
CALIF.(S)	5	38	1	-37	-0.97	$12,200,000.00	$600,000.00	($11,600,000.00)	-0.95	$321,052.63	$600,000.00	$278,947.37	90	42	-48	-0.53
WASHINGTO	9	99	20	-79	-0.80	$22,817,308.00	$4,400,800.00	($18,416,508.00)	-0.81	$230,477.86	$220,040.00	($10,437.86)				-0.17
CALIF.(N)	18	23	5	-18	-0.78	$4,588,991.00	$645,000.00	($3,943,991.00)	-0.86	$199,521.35	$129,000.00	($70,521.35)	43	29.5	-13.5	-0.31
MICHIGAN	10	59	9	-50	-0.85	$13,687,917.00	$2,297,800.00	($11,390,117.00)	-0.83	$231,998.59	$255,311.11	$23,312.52	531	318	-213	-0.40
MASSACHUS	9	33	7	-26	-0.79	$6,664,738.00	$1,000,000.00	($5,664,738.00)	-0.85	$201,961.76	$142,857.14	($59,104.61)	208	121	-87	-0.42
CONNECTIC	8	33	3	-30	-0.91	$7,878,954.00	$545,000.00	($7,333,954.00)	-0.93	$238,756.18	$181,666.67	($57,089.51)	126	86	-40	-0.32
NEVADA	1	2	0	-2	-1.00	$250,000.00	$0.00	($250,000.00)	-1.00	$125,000.00	$0.00	($125,000.00)	20	10	-10	-0.50
NEW YORK	8	82	4	-78	-0.95	$14,770,000.00	$500,000.00	($14,270,000.00)	-0.97	$180,121.95	$125,000.00	($55,121.95)	84	54	-30	-0.36
MARYLAND	7	51	4	-47	-0.92	$12,231,978.00	$975,284.00	($11,256,694.00)	-0.92	$239,842.70	$243,821.00	$3,978.29	133	65	-68	-0.51
PENNSYLVA	1	0	0	0	0.00	$0.00	[illegible].00	$0.00	0	0	0	0	7	7	0	0
	99	639	104	-539	-0.84	$174,231,954.00	$20,992,422.00	($153,239,532.00)	-0.89	$272,663.46	$201,850.21	($70,813.25)	2829	1562.5	-1266.5	-0.45

NEW JERSEY had some report in pct. others in $.
To keep info above correct we show NEW JERSEY below are incl. in totals below.

	NO. DLRS REPT.	NO. UNITS 1990	NO. UNITS 1991	NO. UNITS DIFF	% DIF	TOTAL $ 1990	TOTAL $ 1991	$ DIFF	% $ DIFF	AVG. VALUE 1990	AVG. VALUE 1991	DIFF IN VALUE	EMP 90	EMP 91	DIFF	% DIFF
	32	32	7	-25	-0.78			($40,000,000.00)		$0.00	0	$0.00	374	228	-146	-0.39
	131	671	111	-564	-0.84			($193,239,532.00)		$278,183.44	$201,850.21	($76,333.23)	3203	1790.5	-1412.5	-0.44

Note: Walter Johnson of Johnson & Towers in New Jersey conducted a very comprehensive survey.
Some of the results were reported in dollar values and others in percentage.
As a result we included all the information possible to add collectively to this summary.

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MRAA
Marine Retailers Association of America

MORRIS M YACHTS

Builders Of Fine Cruising Auxiliaries
Clark Point Road, Southwest Harbor, Me. 04679
Tel. 207-244-5509 Fax. 207-244-5866

June 19, 1991

Committee on Finance, U.S Senate
SD-205 Dirksen Building
Washington, DC 20510
Att: Mr. Lloyd Benson, Senate Finance Chairman

Dear Mr. Benson,

I read in The Wall Street Journal where you have become an authority on used boat sales (see attached). I would hope you will stick to the problems of politics if that is your profession and listen to others who have some experience in the business of boats.

I have been building boats since 1972; that's nineteen years of experience. I have survived oil embargoes and recessions and am proud to say that I have laid off only one employee for lack of work over the years.

We build semi-custom sailboats from 28' to 36' ranging in price from $100,000 to $300,000 at the rate of six to seven a year. We employ 22 people: skilled carpenters, mechanics, electricians and fiberglass technicians. We produce 44,000 hours of manufacturing production each year. The value of each boat is represented by 62% labor and 38% materials. That is a high labor content per product. Labor equals jobs, Social Security payments, Income tax payments, IRA deposits and savings. Boat sales equal sales tax revenues.

Since November of 1990 we have not sold one new boat (note 1). Does the recession hurt ? You bet! The Luxury Tax on top of the recession and sales tax is murder. Contrary to your observation in The Wall Street Journal, we have sold five used boats in the same time period. Does the recession hurt ? You bet! Used boat prices are soft.

(1) enclosure letter from John Mullen, Dallas Texas

Since November our crew has shrunk by 3, from 22 to 19. I do not know where it will end but my professional experience tells me there are more layoffs to come. For a lousy $3 million dollars in projected tax revenues from boats less the cost of collecting the tax revenue, the jobs lost and those that lay ahead is an exercise in lousy economics. Why not tax second home construction and art ? Aren't they luxuries? Why pick on boat builders? We are producing a quality product with American labor. I don't know what your priorities are in Texas. Ours is to build boats.

Get this monkey off our back and allow us to help pull this economy out of recession.

Thomas D.C Morris
Thomas D.C Morris
President, Morris Yachts

c.c Olympia Snow
George Mitchell
Bill Cohen
John Mullen

MARKETING WSJ 6/12/91

Conceived to Soak the Rich, Luxury Tax Stings Sellers of Boats, Bracelets, BMWs

By David Wessel
And Jackie Calmes
Staff Reporters of The Wall Street Journal

Extra Bite

The U.S. luxury tax is 10% of the purchase price above:

$10,000	for furs
$10,000	for jewelry
$30,000	for autos
$100,000	for boats
$250,000	for airplanes

Now You Can Have Jaguar Luxury, Free Of The Luxury Tax.

Jaguar's ad offering to refund the luxury tax on the purchase of its car

WASHINGTON—The luxury tax, conceived by congressional Democrats to show they were being tough on the rich, may be generating more trouble than revenue.

Yacht builders are blaming the levy for layoffs. Retailers near the borders say the paper work discourages foreign tourists (who are exempt) from buying. Jewelers say the tax is more intricate than a Swiss watch. The European Community says it may be an unfair trade practice. Auto dealers say sales of high-priced cars are off so much that the tax won't raise the expected revenues.

And the disabled, who suddenly find some specially equipped vans now deemed luxuries because of the added cost, are complaining. "It is no luxury. I certainly wouldn't drive one if I didn't have to," says Myron Taylor, a Farmington, N.M., banker who recently paid a luxury tax of $396.20 on a Dodge van that was modified so he can drive from his wheelchair.

In fact, the luxury tax is drawing more bellyaching than nearly any other provision of last year's $500 billion, five-year deficit-cutting law. Some in Congress are beginning to listen. The Senate Finance Committee holds hearings today on proposals to repeal all or part of the tax on expensive cars, boats, planes, furs and jewelry—including one bill to exempt the handicapped from the car tax.

As implausible as it sounds, Senate Republican Leader Robert Dole, from the plane-building state of Kansas, says repeal is the GOP answer to the Democrats' campaign for tax fairness. "A lot of middle-class people are losing their jobs," says Sen. Dole, who yesterday introduced a bill to repeal the tax. Senate Democratic Leader George Mitchell, from the boat-building state of Maine, says he will support repeal "if the evidence establishes that because of the tax, sales have declined . . . many jobs have been lost and there has been no increase in revenue."

For all the second thoughts, though, repeal is still a long shot. It isn't clear that any tax bill will move through Congress this year. And many members of Congress are skeptical about claims that the tax is to blame for the all the woes of the boat builders and car dealers. For one thing, vendors pumped up sales late last year by warning customers in ads that the tax would be imposed on Jan. 1. What's more, says Senate Finance Chairman Lloyd Bentsen, "The reason new boats and airplanes aren't selling is because of this recession we're in." Adds the Texas Democrat: "Even second-hand boats aren't selling, and it's because of the recession."

To which repeal-advocate Democratic Sen. John Breaux of Louisiana replies, "If they were sinking before, I think we pushed them under water."

Shepard McKinney, owner of Hinckley Co., which builds sailboats in Southwest Harbor, Maine, is convinced that the tax is compounding the problems presented by the recession. "Everybody mentions it," he says. "It doesn't take a high-priced lawyer [to avoid the tax]. You just don't buy the boat."

The tax on boats is 10% after the first $100,000. Since Hinckley's boats cost between $400,000 and $1.5 million, the tax amounts to an additional $30,000 to $140,000. In all, the Treasury estimated that the luxury tax would bring in $1.5 billion over five years. It's too soon to tell if that estimate was right.

Boat builders are making the most noise about the luxury levy—and are making the most headway on Capitol Hill as well. But sales of high-priced autos are also off sharply. Most of the pain is felt by European auto companies whose problems draw little sympathy from U.S. lawmakers. Overall auto sales in the U.S. in the first five months of 1991 were off about 1?%; but sales of Jaguars were off 55%, and the company is now advertising that it will rebate the luxury tax—as much as $3,360—on certain models. "It's something we feel we have to do," says Michael Cook, spokesman for the U.S. unit of Jaguar Cars Ltd. "Our dealers say it's a definite issue."

"It makes a huge amount of difference," says Peter Terian, owner of Rallye Motors Inc. of Roslyn, N.Y. "Our business is down 50% on Rolls-Royce, Mercedes and BMW. A lot of it is the economy, for sure. But you see it [the luxury tax] when some-

Please Turn to Page B8, Column 2

Passed to Soak Rich, Luxury Tax Is Dampener for Many Businesses

Continued From Page B1

one is presented with an extra $6,000 or $7,000 on a $100,000 purchase." To help spur sales, Rolls-Royce also is offering a luxury-tax rebate with ads that read: "If the luxury tax is all that separates us, it's time to talk."

On autos, the tax is 10% of anything over $30,000, and the law says the total includes any equipment installed in the first six months after the car is purchased. That is what snagged Mr. Taylor, the New Mexico banker, who has multiple sclerosis. After a local company, Independent Mobility Systems Inc., lowered the floor of a Dodge Caravan and otherwise altered the vehicle for a wheelchair, the price was up to $33,962; the tax was 10% of the amount over $30,000, or $396.20.

"The worst part of it is that the more severe the handicap, the larger the tax because the more sophisticated the equipment they need," says Greg Anesi, president of Independent Mobility. Mr. Anesi is scrupulously complying with the new law, but two dealers contacted by The Wall Street Journal are evading it—either by improperly billing customers separately for the van and the modifications or basically ignoring certain provisions.

The ins and outs of what appeared to be a straightforward tax have unleashed a torrent of complaints. Neiman Marcus, the upscale retailer, is upset that the Internal Revenue Service wants to require foreigners to produce both a passport and an airplane or boat ticket to escape the tax; a passport should be sufficient, the unit of General Cinema Corp. argues. The IRS says the tax applies to any garment in which fur is more than 25% of the surface area; the fur trade wants the tax to apply only to garments in which fur is 50% or more. The IRS is weighing these and scores of other complaints about its proposed rules.

Jewelers are particularly vocal about a provision that applies the tax to jewels that a customer wants to have reset. Say a customer takes a diamond brooch to a jeweler and asks that the stones be reset as a necklace. The jeweler charges only $1,000 for labor and materials. But the IRS says he must figure the fair market value of the new necklace. If it's $12,000, then the tax is $200, or 10% of the amount over the $10,000 threshold for jewelry.

"No consumer can understand why they should pay a tax on something they've owned for 20 years," says Michael Roman, chairman of the Jewelers of America, a trade group.

Tough luck, the IRS says. It would exempt only repairs and slight modifications, such as resizing a ring or converting earrings from pierced to clip-on.

The IRS does offer this somewhat extreme example of a "repair" that is exempt from the tax: "A customer brings a ring to a jeweler and claims to have lost a 2-carat round diamond from the setting. The customer selects a $30,000 stone. The jeweler examines the setting but is unable to either confirm or disprove the customer's claims. The jeweler . . . relies on the customer's signed certification that a 2-carat round diamond . . . was lost."

2 December 90

Thomas Morris
Morris Yachts
Clark Point Road
Southwest Harbor
Maine 04679

Dear Tom,

I apologize for taking so long to respond to your letter of early November that included the final specifications and detail drawings of the Morris 44. You and Chuck Paine have obviously put a great deal of time and effort into the refinement of the design. Since we first spoke over a year ago, she has evolved into our dream boat.

I had expected to be sending you a deposit check so that you could begin the tooling immediately. However, I now find that we can not proceed further. It now appears that Anne and I will not be ordering the 44. The newly passed federal ten percent tax over $100,000 has essentially put her out of reach.

While this tax is a personal tragedy for Anne and me, for your industry and all your highly skilled workers it is a disaster. It will clearly have a negative impact on employment and it will severely hurt one the few remaining industries in this country which is known worldwide for absolute top quality. I understand that David Walters has shut down Cambria Yachts, a great loss for us all.

Anne and I will reach fifty shortly, and prior to this new tax had been on track for the plan we made when we were married twenty-five years ago. We purchased our only home for forty thousand dollars in 1968 and paid off the twenty-year mortgage two years ago. Our son, Mark graduated from college a year and a half ago and is doing well on his own now. Our daughter, Kate graduated just last June and called this week to say that she is teaching full time and waiting tables at night. She also is launched. We paid cash for our kids educations and have always avoided debt. We chose never to buy a second home and have usually focused on sailing vacations. We own a 1959 Rhodes Swiftsure 33 sloop with three other families and have used it to develop our family's sailing skills. We have saved faithfully for our "Before Fifty" dream for twenty-five years. My architectural practice was reasonably successful until the recent recession in the building industry, but fortunatey an investment in starting a new retail chain has proved fruitful. Now Congress has decided that Anne and I are excessively wealthy and that if we want one of your wonderful boats that we must pay a luxury tax for a floating second home instead of having the interest deduction that Congressmen and others use for their second homes. We have always paid our taxes and never participated in any of the tax scams that were floating around for years, and now--mad as I am--I refuse to use an offshore corporation to buy a boat even if Congress tells me to.

Tom, I am not sure where we are heading now. I am afraid it will be to buy a used boat of significantly lesser quality. Anne sends her best. Thank you for all the time you have put into this effort. Let's keep in touch. Best regards,

John Mullen 5365 Montrose Drive Dallas, Texas 75209

STATE OF RHODE ISLAND, DEPARTMENT OF ECONOMIC DEVELOPMENT,
Providence, RI, June 26, 1991.

United States Senate,
Committee on Finance,
SD 205 Dirksen Building,
Washington, DC.

Dear Committee Members: As Director of the Rhode Island Department of Economic Development, I am writing to implore Congress to repeal the Boat Excise Tax by passing legislation 8.649/HR 951. At a time when Rhode Island is struggling through the worst economic downturn since the Great Depression, it is not appropriate to impose a Federal tax that puts out of business a number of Rhode Island manufacturing companies that pay high wages, employ thousands, and export millions of dollars worth of products to other states and countries.

It is very difficult for the State of Rhode Island to attempt to bring new business into the state in during these trying times. Therefore, the Department has refocused its goals and it now concentrating on maintaining business in the state and helping those companies expand and prosper. I believe that the boat tax, if not repealed, will harm our boat building and manufacturing base, which has taken some thirty years to develop.

I ask you to please consider passing the aforementioned legislation.

Sincerely,

JOSEPH R. PAOLINO, JR., *Director.*

STATEMENT OF THE SHANNON BOAT COMPANY

Shannon Boat Company was founded by Walter Schulz in 1975 in Bristol, R.I. with the goal of building top-end semi-custom limited production yachts. Shannon established a reputation for quality known worldwide, and by 1986 employed 110 people with approximately $5 million in annual sales. Shannon's models include 37', 43', and 51' sailboats and 36' motor yachts costing from $250,000 to $700,000. While the current U.S. recession caused a slow-down in sales, Shannon was weathering this economic downturn as it had weathered the 1975 and 1981 U.S. recessions. Even during the Great Depression of the 1930's America's yacht builders had work. During the period beginning January 1, 1990 to May 1, 1990, Shannon sold three sailboats and two motor yachts worth $1.7 million and had 61 employees. During the period beginning January 1, 1991 and ending June 1, 1991, Shannon had no new boat sales with 28 employees. A sailboat order worth $260,000 was canceled in late 1990 because of the imposition of the excise tax.

Two sailboat orders and one motor yacht order worth $1.3 million are on hold by the purchasers pending the outcome of efforts to repeal the tax. As of today there is no work from new Shannon boat orders. Approximately 70% of Shannon's annual sales occur during the Fall Boat Show season and with this tax in place the prospects are dim for any sales if this tax is not repealed prior to the first boat show in late August.

Shannon's highly-specialized skilled craftsmen earn an average of $12.80 an hour but their skills cannot be absorbed in the current depressed R.I. economy and the lucky few who find work will earn $5 an hour at best. It is impossible to reassemble such a unique and talented workforce after major layoffs and it takes years to resume efficient yacht production. Being a start up under-capitalized entrepreneur venture, Shannon never had the necessary funds to actively market overseas although Shannon's superior quality has been appreciated by German, Italian, and English yachtsmen who have bought Shannons. Unlike other countries, the U.S. has never helped American boat builders export overseas even though American boats are acknowledged as preeminent throughout the world.

With the longevity of fiberglass as a hull material, used boats are an alternative to new construction. The imposition of this 10% excise tax makes the differential between new and use boats even more dramatic to the disadvantage of new construction. As an example, three used Shannon sailboats were bought by purchasers this Spring who would have considered new boats if the excise tax was not in effect.

Admittedly, some rich people probably could afford in absolute terms to pay another $20,000 on a $300,000 boat, but the relative price in-elasticity of high ticket discretionary non-essentials like yachts makes small percentage price increase result in no sales. At Shannon, in 16 years of building and selling direct 316 boats costing over $100,000, if prices were more than 3% greater than perceived public

value, then sales dropped dramatically. The excise tax adds 7% to the cost of a $300,000 boat but does nothing to enhance perceived public value. The refusal of banks to finance the 10% excise tax and state sales tax increases Significantly the down payment from 20% to almost 40%. Because of the capital intensive nature of the manufacturing process (large and expensive molds for hulls and decks that require large buildings, big cranes and boat moving equipment, long apprenticeship and training requirements, complete woodworking shops, etc.) it is not possible to incrementally reduce a work force to reflect decreased sales. Also, because of the absence of the supplemental unemployment benefits enjoyed by other manufacturing industries like automobiles, skilled boat builders do not have the option of staying unemployed until business picks up. Once boat builders are laid off, they are forced to try to find alternative employment almost immediately to pay bills, and buy groceries, etc., and then they cannot be recalled when sales do pick up.

In summary, the 10% Federal boat excise tax has already caused enough slowdown in Shannon's sales to jeopardize severely our ability to survive. The recession alone does not account for this slowdown. Once Shannon's workforce is laid off, the ability to reassemble it is very questionable. Shannon is a representative example of America's boat building industry. The enactment of such a revenue-negative and hastily conceived tax verges on criminal neglect. The auctioning in receivership this Spring of Cape Dory, Bristol, and Pearson/O'Day Yachts, three of the most famous U.S. boat manufacturers, all successful for at least 25 years with over 1200 employees total at their peak, is indicative that the 10% boat excise tax is a tragic mistake that can be corrected only by swift Congressional action with complete cooperation from President Bush.

Statement of the U.S. Chamber of Commerce

The U.S. Chamber of Commerce appreciates this opportunity to present its views on S. 649, legislation to repeal the luxury tax on boats.

LUXURY TAXES

The Chamber strongly supports repeal of the 10 percent luxury excise tax which the Omnibus Budget Reconciliation Act of 1990 imposed on jewelry, furs, automobiles, boats and aircraft. This tax was imposed on the excess of sales prices over $10,000 for furs and jewelry; over $30,000 for passenger vehicles; over $100,000 for boats and over $250,000 for aircraft. The Joint Committee on Taxation estimated that the new luxury excise taxes would generate $1.479 billion over FY 1991-1995.

Congressional intent behind the luxury excise tax was to increase tax receipts from higher-income individuals by taxing items considered to be purchased primarily by the wealthy. However, the distribution of the tax burden depends on all the chain-reaction income changes resulting from the imposition of the tax. The burden of the tax falls not only on those taxpayers who purchase the goods, but also on the taxpayers who earn their money from these purchases. Although lower-income households may not purchase the luxury goods and therefore not be directly liable for the tax, they tend to suffer most from the resulting economic distortions created by the tax. An April 1991 study by the Congressional Research Service concludes that the person who pays the tax is not necessarily the person who really bears the burden of the tax.

When consumers change their consumption patterns in response to the imposition of a tax, the composition of output is altered. As sales decline, output and employment are reduced, resulting in lower taxable business receipts and wage income, thus reducing federal and state income tax and sales tax receipts. Besides adversely affecting the manufacturers and retailers of the taxed goods, the luxury tax also negatively affects the businesses that service and supply these important industries. The net result for the economy is a decline in the gross national product.

When the Joint Committee on Taxation estimated the revenue impacts of the luxury taxes, they assumed no change in consumption. However, consumption has changed and when one considers the resulting lower corporate and individual federal and state income tax revenues, decreased state and local sales tax receipts, reduced FICA taxes, and increased unemployment insurance payments, it is easy to understand how luxury taxes will generate significantly less—even negative—revenue.

S. 649

Senators Breaux, Chafee and Pell have introduced S. 649, legislation to repeal the luxury tax on boats. Similar legislation has been introduced in the House by Representatives Hertel (H.R. 613); Shaw (H.R. 951); Saxton (H.R. 1020); and Snowe (H.R. 2487). The luxury tax has had a devastating impact on the marine manufacturing industry. The National Marine Manufacturers Association estimates that more than 19,000 jobs will be lost this year because of this tax.

Boat sales have declined severely since the tax took effect on January 1 of this year. The boat manufacturing industry is almost exclusively composed of small, family-owned businesses. Because of their size and close operating budgets, these manufacturers are particularly vulnerable to sales fluctuations and many are closing, or have already closed, their doors. As a result, the boating industry estimates federal corporate tax payments will fall by more than $60 million this year.

AUTO LUXURY EXCISE TAX

Not only has the boat manufacturing industry been harmed by the luxury tax. A report prepared for the Federation Against Inequitable and Regressive Taxation (FAIRTAX) indicates the 10 percent luxury tax has created a 20 percent permanent drop in the demand for vehicles priced over $30,000—representing lost sales in 1991 alone of $1.31 billion for automobile dealerships. As a result of the tax, the report projects for 1991 a loss of 3,320 jobs, and a further loss this year of $135 million in revenue from customs duties, state sales taxes and federal income and gas guzzler taxes.

Many erroneously assume the luxury tax applies primarily to imported vehicles. Automobile industry economists estimate more than 65 percent of the autos sold at prices exceeding $30,000 in the 1990 model year were produced by domestic manufacturers. When factoring in inflation and the regulatory costs imposed by the Clean Air Act, the same vehicle that costs approximately $24,300 today will become subject to the tax by 1995. This is equivalent to lowering the threshold for the tax in 1995 to include even more models. As a consequence of imposition of the luxury tax, the industry will experience reduced sales and substitution of lower-priced automobiles. This in turn will result in lower profits for domestic manufacturers, dealers, and suppliers, thus lower federal income tax payments.

JEWELRY LUXURY TAX

Jewelry sales have also been harmed by the luxury tax. The jewelry industry is particularly concerned that recently proposed IRS regulations could be interpreted as an ad valorem tax capable of being imposed on the value of a particular piece of jewelry as many times as it is modified. The imposition of this luxury tax presents special problems for grandmother's jewelry." If a jeweler sold a diamond worth $8,000 to a customer to be put into her existing mounting, valued at $40,000, the customer would be subject to the luxury tax on $38,000, the total value of the piece over the $10,000 threshold. Customers are often saddled with luxury tax liability that far exceeds the cost of the modification. The tax also results in unrealistic appraisal requirements for jewelers.

AIRCRAFT LUXURY TAX

Senator Kassebaum (S. 1239) and Representative Glickman (H.R. 2581) have introduced legislation to repeal the luxury excise tax on aircraft. Sales of personal-use aircraft have also declined due to imposition of the luxury tax. For example, Beech Aircraft Corporation, a large manufacturer of owner-flown aircraft, has lost 39 direct retail contracts in the first quarter of 1991 as a direct result of the luxury tax. This represents $77.6 million in lost retail sales, 255 foregone labor years, and millions of dollars in reduced federal and state taxes. In contrast, $16,000 in luxury excise taxes were collected on the two airplanes Beech did sell in the first quarter of this year.

In addition, the proposed luxury tax rules unduly burden dealers of new planes. Dealers can quickly become liable for the luxury tax if the 30-hour flight time limit is exceeded during demonstrations. The tax may also be imposed on a subsequent sale within two years of the first retail sale if the aircraft ceases to be used for exempt purposes, requiring dealers to monitor the use of the aircraft after the purchase.

FUR LUXURY TAX

The fur industry is reeling from the effects of the recession. Because of the economic downturn and problems in the world pelt market, profits for the fur industry are down dramatically. Imposing a luxury tax further exacerbates the industry's problems. It is important to remember that an excise tax was imposed on all furs after World War I, but was repealed in the 1960's because it cost the government more to collect the tax than it generated in revenues.

Small businesses compose more than 80 percent of the fur industry, and mink, the largest selling fur in the U.S., is produced domestically. Many in the industry must absorb the cost of the luxury tax just to retain sales. The luxury tax is imposing a hardship on the industry at a time when it can least afford the extra burden.

CONCLUSION

The luxury tax imposed by the 1990 budget act is an ill-conceived tax from both a policy and an administrative viewpoint. The net effect of these taxes will be significantly reduced revenues, the loss of thousands of jobs for the American work force, and extra administrative burdens placed on both the IRS and American businesses. In the end, the burden of luxury taxes will not be borne by the "rich," but by the Americans who will lose their jobs or their businesses because of declining sales. Clearly, the 10 percent luxury tax on aircraft, automobiles, boats, furs, and jewelry should be repealed.

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